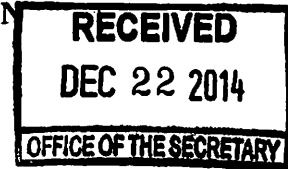


**UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION**

**ADMINISTRATIVE PROCEEDING
File No. 3-15873**



In the Matter of

**Thomas R. Delaney II and
Charles W. Yancey**

Respondents

RESPONDENT CHARLES W. YANCEY'S POST-HEARING BRIEF

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INTRODUCTION

In this case, the Division seeks an unparalleled and unsupported extension of well-established supervisory standards, which, if allowed, would impose an insurmountable burden of due diligence on every regulated CEO in the United States' securities industry. The Division seeks to hold Bill Yancey, the former President and CEO of Penson Financial Services, Inc., responsible for failing to supervise two individuals based on violations of a highly technical rule, of which the SEC concedes Mr. Yancey was not made aware and were actively concealed from him. Not one witness supported the Division's theory of liability at trial. Instead of suing the individuals who violated the rule, the SEC has chosen to sue those who did not catch them. This is a classic example of a case that should never have been filed.

The trial record overwhelmingly demonstrates that Yancey did not fail reasonably to supervise Michael Johnson because Johnson was not subject to his supervision—Yancey unequivocally and reasonably delegated supervision of Johnson to Phil Pendergraft. Almost a dozen witnesses testified to this fact. Indeed, Pendergraft himself admitted that he supervised Johnson. No evidence—including the erroneous supervisory matrix—can change the fact that Pendergraft was actively and comprehensively supervising Johnson.

The Division also failed to prove that Yancey did not reasonably supervise Tom Delaney. It is undisputed that Yancey did not know about the underlying Rule 204(a) violations and that they were actively concealed from him. Instead, the Division asserts that four “red flags” should have alerted him to the violations. At trial the Division all but abandoned two of these purported “red flags,” and the remaining two deserve no better fate. The Division asserts that the results of a Rule 204(a) audit in December 2009 should have alerted Mr. Yancey to the violations, but the Division concedes that: (1) the audit did not test the transactions at issue in this case and (2) the

issues identified in the audit were promptly remediated.

The trial record could not be more clear—Yancey was an engaged, accessible, ethical, and honest CEO, whose leadership fostered a culture of open communication, accountability, and integrity. For issues that rose to Yancey’s attention, he responded reasonably and decisively. To find a failure to supervise on these facts would suggest that neither Yancey—nor any CEO—can rely on business line supervisors and properly qualified licensed individuals and experts, including supervisory delegates, to perform their duties. The Division seeks to advance a standard of omniscience for CEOs that ignores decades of settled case law, would cause uncertainty and confusion among senior-level managers at broker-dealers as to their supervisory responsibilities, and would significantly undermine long-standing concepts of reasonable supervision. The claims against Yancey should be dismissed.

ARGUMENTS AND AUTHORITIES

The background and facts of this case are set forth in Respondent Yancey’s proposed findings of fact, pre-hearing brief, and expert reports. The applicable legal standards are set forth and organized in Respondent Yancey’s proposed conclusions of law and pre-hearing brief.

I. The Division Failed to Prove that Bill Yancey Failed to Supervise Michael Johnson.

The trial record overwhelmingly demonstrates that Yancey did not fail reasonably to supervise Johnson because Johnson was not subject to his supervision—Yancey reasonably and appropriately delegated supervision of Johnson to Phil Pendergraft. Indeed, even if Johnson *had* been subject to Yancey’s supervision, the Division’s failure to supervise claim must fail because the record unequivocally establishes that Johnson was reasonably supervised.

A. Yancey reasonably delegated supervision of Mike Johnson to Phil Pendergraft.

1. Yancey clearly and unequivocally delegated supervisory responsibility for Mike Johnson to Phil Pendergraft.

The president and CEO of a firm is responsible for the firm's compliance with all applicable requirements unless and until he reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his or her duties.¹ The Commission "has long recognized that individuals . . . who may have overarching supervisory responsibilities for thousands of employees must be able to delegate supervisory responsibility"²

Delegation of supervisory responsibility can be formal or informal.³ Indeed, the act of delegation need not be ceremonial, or even written.⁴ An informal delegation occurs when, through the actions and words of the involved parties, the parties understand that supervision has been delegated.⁵ Courts consistently apply the test developed in *Gutfreund* and its progeny to determine whether supervisory responsibility has been appropriately delegated.⁶ Under

¹ *John B. Busacca III*, Exchange Act Release No. 63312, 99 SEC Docket 34481, 34496 (Nov. 12, 2010).

² *In the Matter of Patricia Ann Bellows*, SEC Admin. Proc. File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *8 (July 23, 1998).

³ *In the Matter of Swartwood Hesse, Inc.*, Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *6 (Sept. 22, 1992) (where all parties testified about delegation of supervisory authority, Commission concluded president successfully delegated supervisory authority to another, even if no formal delegation and even if broker-dealer's trader testified that he had "no idea" whether president delegated his "compliance responsibility").

⁴ *Swartwood*, 1992 WL 252184 at *5 (Sept. 22, 1992) ("the fact that there was no written documentation to support this division of authority is not dispositive of the issue"); *In the Matter of Raymond James*, SEC Admin. Proc. File 3-11692, Initial Decision Release No. 296, 2005 WL 2237628 at * 47 (Sept. 15, 2005) ("The fact that [broker dealer's] CEO did not formally delegate to [delegatee] responsibility for the . . . supervisory procedures does not change the fact that [delegatee] was responsible for supervising [supervisee]. [Delegatee] controlled [supervisee's] activities," and was responsible for hiring and firing supervisee) (Prop. COL 12).

⁵ *Swartwood*, 1992 WL 252184 at *6 (where all parties testified about delegation of supervisory authority, Commission concluded president successfully delegated supervisory authority to another, even if no formal delegation); *In the Matter of Universal Heritage Invs. Corp.*, 47 S.E.C. 839, 845, 1982 WL 525157 at *5 (1982) (finding delegation where president delegated responsibility for day to day responsibility of firm to another) (Prop. COL 13).

⁶ *Bellows*, 1998 WL 409445, at *9 (citing to the *Huff* test of "who had control over the individual acts of the [supervisee]" as the standard for deciding whether delegation has occurred, and using the *Huff* standard to conclude that president of broker-dealer had appropriately delegated supervisory authority to another individual, and, therefore, was not liable for failing to supervise individual) (citing *Arthur James Huff*, 43 SEC Docket 878, 891

Gutfreund, “determining if a particular person is a supervisor depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue.”⁷ An individual’s ability to discipline;⁸ advise regarding the particular regulatory rule at issue;⁹ affect the conduct at issue;¹⁰ fire;¹¹ assess performance;¹² assign, direct, or approve activities;¹³ promote;¹⁴ and approve leave¹⁵ are all indicia of supervisory authority over an employee. No one piece of evidence is dispositive of delegation.¹⁶

Here, the overwhelming weight of the evidence supports the conclusion that in August 2008 Yancey delegated supervisory responsibility over Johnson to Pendergraft. It is undisputed

(Mar. 28, 1991)); *SEC v. Yu*, 231 F.Supp.2d 16, 20-21 (D.D.C. 2002) (relying on *Gutfreund* to analyze whether president of broker dealer reasonably delegated supervisory authority and specifically noting that “the Commission has long taken the position that a person’s classification as a ‘supervisor’ turns on ‘whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of employees’”) (citing *In the Matter of Gutfreund*, Exchange Act Release No. 31554, 1992 WL 362753 at *15 (1992)); *In the Matter of Midas Sec., LLC*, Exchange Act Release No. 34-66200, 2012 WL 161938 at *13 (Jan. 20, 2012) applying *Gutfreund* factors to analyze whether president delegated supervisory authority to subordinate and noting, “[i]n addition, [president] admitted that [subordinate] could not incur office expenses on behalf of the firm and could not hire, fire, or approve the registered representatives’ leave from the office—i.e., indications that could otherwise signal [supervisee’s] supervisory authority over the registered representatives”); *Raymond James*, 2005 WL 2237628, at *47 (in delegation case, citing both *Huff* and *Gutfreund* and noting that the “most probative factor as to whether a person is responsible for actions of another is the power to control another’s conduct”).

⁷ *In the Matter of John H. Gutfreund*, 51 S.E.C. 93, 113 (Dec. 3, 1992); see also *In the Matter of Theodore W. Urban*, SEC Admin. Proc. File 3-13655, Initial Decision Release No. 402 (Sept. 8, 2010); *In the Matter of George Kolar*, 202 SEC LEXIS 3420 (June 26, 2002).

⁸ See *In the Matter of Ronald S. Bloomfield*, Exchange Act Release No. 34-71632, 2014 WL 768828, at *11 (Feb. 27, 2014) (“As we have held, an individual’s ability to discipline and, especially, to fire an employee are indicia of supervisory authority over that employee.”); see also *Midas*, 2012 WL 161938 at *13 & n.73 (Jan. 20, 2012); *George J. Kolar*, 2002 WL 1393652, at *4 (June 26, 2002).

⁹ *In the Matter of Arthur James Huff*, 1991 WL 296561 at *9.

¹⁰ *Ronald S. Bloomfield*, 2014 WL 768828, at *11 (“With respect to the [branch office’s] activities, [alleged supervisor] testified that he believed that he had “unfettered” authority to act as necessary, including the authority to dismiss [the supervisee], to “shut down” [the supervisee’s] penny stock business, and to close the [branch office].”).

¹¹ See *In the Matter of Stephen J. Horning*, SEC Admin. Proc. File 3-12156, Initial Decision Release No. 318, 2006 WL 2682464, at *10 (Sept. 19, 2006).

¹² See *Urban*, 2010 WL 3500928, at *27.

¹³ See *id.*

¹⁴ See *id.*

¹⁵ See *Midas*, 2012 WL 161938, at *13.

¹⁶ *Swartwood*, 1992 WL 252184 at *5 (“the fact that there was no written documentation to support this division of authority is not dispositive of the issue”) (Prop. COL 18).

that prior to August 2008, Johnson reported to Yancey.¹⁷ In August 2008, Penson combined the stock lending departments of its various subsidiaries, including PFSI, into a new Global Stock Lending department, and Johnson was promoted from PFSI to PWI to lead the new department.¹⁸ In connection with that combination and promotion, Yancey delegated—and Pendergraft accepted—supervisory responsibility over Johnson. Pendergraft then directed Penson’s Vice President of Human Resources, Dawn Gardner, to move Johnson out of Yancey’s organization (PFSI) and into Pendergraft’s organization (PWI).¹⁹

The record is replete with evidence confirming that this delegation was clear and unequivocal. Penson’s organization charts clearly reflect this delegation. Before August 2008, Penson’s organization charts listed Johnson as a PFSI employee reporting to Yancey.²⁰ After August 2008, however, Penson’s organization charts listed Johnson on the same level as Yancey, reporting to Pendergraft, Engemoen, and Son.²¹

Johnson, Pendergraft, and Yancey all unequivocally confirmed the delegation. Johnson testified that after he was promoted to PWI in August 2008 he no longer reported to Yancey—he was supervised by and reported to Pendergraft and/or Dan Son.²² Indeed, Johnson regularly

¹⁷ See Stip. FOF 118; Ex. 555; *see also* Gardner Test. at 1148:23-1149:2 (“Q: Prior to August 2008, who did Mike Johnson report to? A: Bill Yancey. Q: And who was Mike Johnson supervised by? A: Bill Yancey . . .”).

¹⁸ Gardner Test. at 1149:3-13 (“Q: Was Mike Johnson moved into the PWI organization at some time? A: Yes, he was. Q: Do you know about when that was? A: August of 2008.”); Yancey Test. at 947:3-948:22 (“A: . . . In the summer of 2008, Mr. Pendergraft came to me and cast a big vision for developing a global security lending Senior Vice President role . . . and he said, and I want Mike Johnson to run that group.”).

¹⁹ See Ex. 608 (August 2008 email from Pendergraft: “Effective with the 8/31 payroll, Mike Johnson should be moved to PWI payroll, and his salary adjusted to 600k per year.”); Gardner Test. at 1150:16-20 (“Q: What do you recall about this document? A: It was instructions from Phil for me to move Mike Johnson over from PFSI to PWI. . .”) (Prop FOF 98).

²⁰ Ex. 555 (Prop. FOF 99).

²¹ Ex. 571 (Prop. FOF 100).

²² Stip. FOF 83, 84; Johnson Test. at 537:15-538:5 (“Q: Did you tell [the Division] that after you were promoted to the PWI position, that the only supervisor you had was either Phil Pendergraft or Dan Son? A: Yes. . . . Q: And during that period of time, did you only have one supervisor, and was that either Mr. Phil Pendergraft or Mr. Dan Son? A: Yes. Q: And you told them that? A: I believe so.”) (Prop. FOF 6).

boasted to others that he reported directly to Pendergraft.²³ Pendergraft himself admitted that when Johnson was moved out of the PFSI organization in August 2008 he became one of *Pendergraft's direct reports*.²⁴ Pendergraft further admitted that he and Yancey spoke multiple times about this transition and that, after the move, Pendergraft directed and controlled Johnson's activities, including his PFSI activities.²⁵ Yancey confirmed that the delegation was clear, comprehensive, and unconditional:

And so I said, so you want to move him under you. And I said, is he going to continue to be engaged in Penson Financial Services matters? And he said, oh, yes. And I said, so you're going to move that department? You're going to let him continue to supervise there? Yes. Then you're going to move that department under your supervision? And he said, yes. And I said, so you become the supervisor for this whole area? And he said, yes, without any limitations. So I fully delegated it to him. He accepted that delegation. And then there became a pattern and practice of follow-up routine communication between Phil and I to ensure that-that his supervision was adequate and-and appropriate.²⁶

...

Q: But did Phil very clearly state to you that he would be Mike Johnson's supervisor?

A: Yes, ma'am.

Q: Did he in any way suggest he was taking on only part of a role or carving

²³ Gardner Test. at 1152:1-6 ("Q: Was Mike Johnson proud of who he reported to? A: Yes, he was. . . he told everyone that he was . . . reporting to Phil Pendergraft at Penson Worldwide."); McCain Test. at 2182:5-15 ("Mike made it clear to everybody that he reported to Phil. There wasn't any question as to who reported to who. If anybody had any question, Mike would set you straight real fast"); Hasty Test. at 1743:25-1744:6 ("Q: . . . you said Mike said he reported to Phil Pendergraft. . . Would you say he would brag about who he reported to? A: Yes."); 1794:24-1795:4 ("I mean, Mike Johnson is not a quiet person. He was very vocal about who he reported to and where he got his directions . . ."); Delaney Test. at 1338:2-1338:13 (Prop. FOF 101).

²⁴ Pendergraft Test. at 1512:10-21 ("Q: . . . At any time. . . do you recall saying to Mr. Yancey that you wanted to put Mr. Johnson under you, that you wanted to take him and put him under you for a global purpose? A: Well, I'm sure that whenever Mr. Johnson. . . whenever I picked up Mr. Johnson as direct report, I'm highly confident that I talked with Mr. Yancey about it. . . I'm sure that whenever that was that I did pick up that direct report, I'm sure there were conversations about that."); 1462:1-7 ("Q: Did you, from 2008 to 2011, supervise Mr. Johnson in his supervision of PFSI's stock lending? A: Well, to the extent that Mr. Johnson provided—well, in certain ways, yes. The PFSI stock lending business rolled up to Mr. Johnson, and Mr. Johnson would have rolled up to me or to somebody else at the -- in the global organization.") (emphasis added) (Prop. FOF 20).

²⁵ Pendergraft Test. at 1512:11-21 ("Q: [D]o you recall saying to Mr. Yancey that you wanted to put Mr. Johnson under you, that you wanted to take him and put him under you for a global purpose? A: Well, I'm sure that . . . whenever I picked up Mr. Johnson as [a] direct report, I'm highly confident that I talked with Mr. Yancey about it.") (Prop. FOF 20); *see also* 1513:5-7 ("in this time frame that Mr. Johnson reported to me, he would have largely taken his direction from me."); 1521:1-11 ("If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question? A: Then I would say that I provided supervision to Mr. Johnson.") (emphasis added) (Prop. FOF 14).

²⁶ Yancey Test. at 948:9-22 (Prop. FOF 21) (Prop. FOF 6).

up that responsibility in any way?
A: No, he didn't. And anything less than full delegation would not have been okay with me.²⁷

That all three of the individuals involved recognized and acknowledged the delegation unequivocally demonstrates that Yancey reasonably delegated supervisory responsibility over Johnson to Pendergraft.²⁸

Other witnesses confirmed that the delegation was unambiguous. Dawn Gardner—the most senior human resources officer at Penson—testified that nobody at Penson was confused about the delegation:

Q: Prior to August 2008, who did Mike Johnson report to?
A: Bill Yancey.
Q: Was Mike Johnson moved into the PWI organization at some time?
A: Yes, he was.
Q: Do you know when that was?
A: August of 2008.
Q: Did Mike Johnson remain in the PWI organization after that period of time?
A: Yes he did.
...
Q: Who was Mike Johnson's supervisor during the time period August 2008 through November of 2011?
A: Phil Pendergraft.
...
Q: [A]re you aware of anyone in the company that was confused about who supervised Mike Johnson?
A: No.²⁹

Delaney testified that Pendergraft explicitly agreed to supervise Johnson in connection with

²⁷ Yancey Test. at 1846:12-19 (Prop. FOF 21) (Prop. FOF 6).

²⁸ *Midas*, 2012 WL 161938 (finding no delegation in part based on testimony of the proposed delegatee); *In the Matter of Johnny Clifton*, SEC Admin. File No. 3-14266, Exchange Act Release No. 34-69982, 2013 WL 3487076 at *12 (July 12, 2013) (taking into account testimony of primary violator in deciding whether supervision had been delegated); *Swartwood*, 1992 WL 252184 at *6 (where all parties testified about delegation of supervisory authority, Commission concluded president successfully delegated supervisory authority to another, even if no formal delegation); Paulukaitis Test. at 488:18-24 ("A: . . . if an individual knows that they're responsible to go to a particular supervisor – a particular principal would be the better way -- that's the person I would go to in order to deal with a question that I have about a particular area; that could be a factor in determining whether that principal is, in fact, a supervisor").

²⁹ Gardner Test. at 1148:23 – 1149:10; 1150:3-6; 1153:24 – 1154:2 (Prop. FOF 102).

Johnson's promotion to PWI.³⁰ And Bart McCain similarly testified that Pendergraft unequivocally agreed to supervise Johnson—"Mike made it clear to everybody that he reported to Phil"—"[t]here wasn't any question as to who reported to who."³¹

Pendergraft's actions prove this point. After the August 2008 delegation Pendergraft actively, consistently, and comprehensively supervised Johnson in every aspect of his job, including regulatory matters. Pendergraft admitted that he evaluated and reviewed Johnson's performance.³² He disciplined Johnson.³³ He approved Johnson's budget and compensation.³⁴ He could overrule or override Johnson's decisions.³⁵ He advised Johnson on customer relations issues, business development plans, and customer client relation plans and budgets.³⁶ He instructed Johnson regarding PFSI firm financing and lending balances.³⁷ And he approved Johnson's travel budget and scrutinized his expenses.³⁸ Pendergraft further admitted that he performed all of these activities within the context of Johnson's responsibilities for PFSI's Stock Lending department.³⁹ These actions conclusively demonstrate that Pendergraft had the "requisite degree of responsibility, ability, or authority to affect the conduct" of Johnson and

³⁰ Delaney Test. at 1332:3-7 ("Q: Okay. Did you understand that with that transition, that Mr. Yancey and Mr. Pendergraft had agreed that Mr. Pendergraft would be the supervisor for Mr. Johnson? A: Yes.").

³¹ McCain Test. at 2182:3-16.

³² Ex. 565 (emails between Pendergraft and Johnson discussing Johnson's performance); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).

³³ Ex. 668 (email from Pendergraft to Johnson discussing breach of internal policies); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).

³⁴ Exs. 521, 627, 684, 791, 796, 797, 809, 506, 527, 590, 636, 664 (emails approving Johnson's compensation budget and requesting report on revenue and expenses of PFSI stock loan); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).

³⁵ Exs. 783 (Johnson seeking Pendergraft's approval); 788 (Pendergraft directing Johnson to implement charges); 790 (directing Johnson to obtain financing); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).

³⁶ Exs. 793, 794, 795, 801, 707, 741, 502, 591 (emails from Pendergraft advising Johnson regarding client relations and approving business development plans); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).

³⁷ Exs. 780, 790, 803, 804, 806, 515, 607 (emails from Pendergraft instructing Johnson regarding financing and lending balances); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).

³⁸ Ex. 517 (email from Pendergraft approving Johnson's travel expenses); 550 (email from Pendergraft requesting information from Johnson on recent expense report); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).

³⁹ Pendergraft Test. at 1536:21-1537:4; 1528:5-1534:9 (agreeing that he performed specific activities) (Prop. FOF 9).

was, therefore, Johnson's supervisor.⁴⁰

Furthermore, nobody at Penson was confused about who supervised Mike Johnson.

Witness after witness after witness confirmed that Pendergraft supervised Johnson:

Witness	Testimony	Cite
Phil Pendergraft	Q: Here is what I want to know. It sounds to me like you're saying, Look, I dealt a lot with Mr. Johnson and I supervised Mr. Johnson, and Mr. Johnson had responsibilities at PWI Canada and he had responsibilities at PFSI Dallas, and I supervised him with respect to those responsibilities. But if—when it comes to regulatory and compliance supervision at PFSI, not me; is that fair? A: Or at any other organization. Q: Or at any other organization. Okay. A: That's correct. *** Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question? A: Then I would say that I provided supervision to Mr. Johnson.	1519:22-1520:7 1521:7-11
Mike Johnson	Q: Did you tell them that after you were promoted to the PWI position, that the only supervisor you had was either Phil Pendergraft or Dan Son? A: Yes. ... Q: And [during the relevant time period], did you only have one supervisor, and was that either Mr. Phil Pendergraft or Mr. Dan Son? A: Yes.	537:15-18 537:25-538:3
Bill Yancey	Q: But did Phil very clearly state to you that he would be Mike Johnson's supervisor? A: Yes, ma'am.	1846:12-14
Dawn Gardner	Q: Who was Mike Johnson's supervisor during the time period August 2008 through November of 2011? A: Phil Pendergraft.	1149:14-16

⁴⁰ *Bellows*, 1998 WL 409445, at *9 (citing to the *Huff* test of “who had control over the individual acts of the [supervisee]” as the standard for deciding whether delegation has occurred, and using the *Huff* standard to conclude that president of broker-dealer had delegated supervisory authority to another individual, and, therefore, was not liable for failing to supervise individual) (citing *Arthur James Huff*, 43 SEC Docket 878, 891 (Mar. 28, 1991)); *SEC v. Yu*, 231 F.Supp.2d at 20-21 (relying on *Gutfreund* standard to conclude that president of broker-dealer had not delegated his supervisory authority. The court specifically noted that “the Commission has long taken the position that a person's classification as a ‘supervisor’ turns on ‘whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of employees’” and relied on facts and circumstances showing that president retained power to “affect the conduct of the employee[s] whose behavior is at issues,” “advise on compliance issues,” and “consult[] on issues including the termination of registered representatives, the supervision of compliance personnel and the hiring of a compliance Inspector”) (citing *In the Matter of Gutfreund*, 1992 WL 362753 at *15 (1992)); *Midas*, 2012 WL 161938, at *13 (in conducting delegation analysis, Commission looked to the *Gutfreund* factors when deciding whether president had delegated supervisory authority to alleged delegatee. The Commission stated “[i]n addition, [president] admitted that [alleged delegatee] could not incur office expenses on behalf of the Firm and could not hire, fire, or approve the registered representatives' leave from the office—i.e., indications that could otherwise signal [alleged delegatee's] supervisory authority over the registered representatives”); see also (Prop. FOF 12, 13).

Tom Delaney	Q: And did you have any ambiguity whatsoever about who Mike Johnson reported to? A: No. Q: And who did Mike Johnson report to? A: Phil Pendergraft.	1216:25-1217:4
Lindsey Wetzig	Q: Were you surprised to get an instruction from Mr. Johnson that was conveying an instruction from Mr. Pendergraft? A: No, sir, not at all. Q: That was a fairly common occurrence, was it not? A: It was common, yes, sir.	417:7-13
Rudy DeLaSierra	Q: Mr. DeLaSierra, given your personal observations and the documents we've discussed, in our experience with supervisors, you would agree that Mr. Pendergraft was supervising Mr. Johnson? A: Yes. Q: Okay. And, indeed, that supervision extended to PFSI activities? A: Yes.	302:22-303:4
Holly Hasty	Q: [Y]ou were never confused about who supervised Mike Johnson; is that right? A: I was not, no. Q: Okay. Who was that? A: Phil Pendergraft. Q: And you are not aware of anyone at Penson who was confused about Mike Johnson's supervisor? A: No.	1794:1-8
Bart McCain	Q: Who was Mike Johnson's supervisor? A: Phil Pendergraft. *** Q: How did you come to that understanding? A: That's like asking why water is wet. That's just the way it was. You know, Phil told me and—and clearly, Mike made it clear to everybody that he reported to Phil. There wasn't any question as to who reported to who. If anybody had any question, Mike would set you straight real fast.	2181:19-20 2182:10-16
Kim Miller	Q: If you had been asked by Mr. Warner in either of your prior two testimonies about who supervised Mike Johnson, what would you have told him? A: He reported to Phil Pendergraft.	2585:9-12
Brian Hall	Brian Hall told the Division that Michael Johnson reported to Phil Pendergraft.	Ex. 446

And lest there be any doubt—*Pendergraft himself admitted that he supervised Mike*

Johnson:

Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question?

A: Then I would say that I provided supervision to Mike Johnson.⁴¹

...

A: I think I was also clear that Mr. Johnson reported to me for his—for the majority of his job responsibility.⁴²

⁴¹ Pendergraft Test. at 1521:7-11 (Prop. FOF 14).

⁴² Pendergraft Test. at 1519:5-7.

...

Q: Did you, from 2008 to 2011, supervise Mr. Johnson in his supervision of PFSI's stock lending?

A: Well, to the extent that Mr. Johnson provided—well, in certain ways, yes. The PFSI stock lending business rolled up to Mr. Johnson, and Mr. Johnson would have rolled up to me or somebody else at the—in the global organization.⁴³

2. Pendergraft supervised every aspect of Johnson's job, including regulatory and compliance functions.

Not surprisingly, the *only witness* who even intimated that Yancey also supervised Johnson was Pendergraft—and even he struggled to articulate it. Pendergraft admitted that he supervised Johnson with respect to every operational aspect of his job. But he disclaimed responsibility for supervision of Johnson's "regulatory and compliance" functions.⁴⁴ Pendergraft's testimony doesn't pass the smell test—it fails under the facts, the law, and common sense.

Pendergraft's attempt to disclaim responsibility for supervision of Johnson's regulatory and compliance activities is overwhelmingly contradicted by the evidence. The trial record establishes that Pendergraft reprimanded Johnson regarding internal policies and regulatory considerations.⁴⁵ Pendergraft directed Johnson to report to him regarding meetings with regulators.⁴⁶ Pendergraft consulted with Johnson about Rule 204 issues.⁴⁷ Pendergraft provided guidance to Johnson about Reg SHO.⁴⁸ Pendergraft even revised and edited communications to

⁴³ Pendergraft Test. at 1462:1-7.

⁴⁴ Pendergraft Test. at 1519:22-1520:7 ("Q: . . . It sounds to me like you're saying, Look, I dealt a lot with Mr. Johnson and I supervised Mr. Johnson, and Mr. Johnson had responsibilities at PWI Canada and he had responsibilities at PFSI Dallas, and I supervised him with respect to those responsibilities. But if – when it comes to regulatory and compliance supervision at PFSI, not me; is that fair? A: Or at any other organization. Q: Or at any other organization. Okay. A: That's correct.").

⁴⁵ Ex. 668 (email from Pendergraft to Johnson discussing breach of internal policies).

⁴⁶ Exs. 563, 638 (emails from Johnson to Pendergraft reporting on FINRA reviews).

⁴⁷ Ex. 730 (email from Johnson to Pendergraft regarding easy to borrow lists and regulatory criteria).

⁴⁸ Johnson Test. at 541:17-544:10 ("Q: Did you talk with Mr. Pendergraft about Reg SHO? A: Yes. Q: Would Reg SHO only have applicability to the broker-dealer Stock Loan function? A: Yes.") (Prop. FOF 10).

PFSI's correspondents regarding Rule 204.⁴⁹ Nowhere in the record is there any evidence of Pendergraft referring these regulatory issues to Yancey. Not one document reflects an instance wherein Pendergraft referred Johnson to Yancey for assistance with a regulatory or compliance matter. All of the evidence establishes that Pendergraft supervised Johnson with respect to every aspect of his job, including regulatory and compliance.

Multiple witnesses also confirmed this fact. Bill Yancey, Holly Hasty, Dawn Gardner, Tom Delaney—all of these witnesses testified that Pendergraft accepted full responsibility for Johnson's supervision absolutely and unconditionally.⁵⁰ Pendergraft's disingenuous attempt to accept the delegation for every aspect of Johnson's supervision except the one aspect that would expose him to liability is demonstrably absurd.

Nor does the law allow Pendergraft to disclaim responsibility for supervising Johnson's regulatory and compliance activities. Under *Gutfreund*, "determining if a particular person is a supervisor depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue."⁵¹ Here, the facts and circumstances conclusively demonstrate that Pendergraft controlled Johnson's conduct with respect to regulatory and compliance matters.⁵² Therefore, as a matter of law, Pendergraft was Johnson's supervisor for regulatory and compliance matters, including for the conduct at issue.

⁴⁹ Ex. 813 (Pendergraft providing revisions on a Special Compliance Memorandum regarding Rule 204).

⁵⁰ Yancey Test. at 1846:12-19 ("Q: But did Phil very clearly state to you that he would be Mike Johnson's supervisor? A: Yes, ma'am. Q: Did he in any way suggest he was taking on only part of a role or carving up that responsibility in any way? A: No, he didn't. And anything less than full delegation would not have been okay with me."); Hasty Test. at 1746:913 ("Q: Did you ever believe that Mr. Pendergraft supervised Mr. Johnson from an operational perspective, and not from a regulatory or compliance perspective? A: No. I don't believe you can separate the two."); Gardner Test. at 1152:7-15 ("Q: And did Phil Pendergraft supervise Mike Johnson's Stock Loan activities? A: Yes, he did. Q: Did he supervise Mike Johnson's PFSI Stock Loan activities? A: Yes."); *see also* Delaney Test. at 1334:16-1336:13 (Prop. FOF 21, 22).

⁵¹ *Gutfreund*, 51 S.E.C. 93, 113; *see also Urban*, Initial Decision Release No. 402; *Kolar*, 202 SEC LEXIS 3420.

⁵² Exs. 668, 563, 638, 730, 813; Johnson Test. at 541:17-544:10 ("Q: Did you talk with Mr. Pendergraft about Reg SHO? A: Yes. Q: Would Reg SHO only have applicability to the broker-dealer Stock Loan function? A: Yes.").

Furthermore, the law does not allow a delegatee to disclaim responsibility for regulatory and compliance matters. As Ms. Poppalardo testified, in her entire career she had never heard of a delegation along the lines of what Pendergraft described:

Q: Have you ever heard of a delegation along the lines of what Mr. Pendergraft described, which is a delegation of operations and business functions, but not regulatory and compliance functions?

A: . . . I feel really strongly that—that you just can’t parse the business activities from the regulatory requirements. It’s a highly regulated industry. Just about everything is regulated right down to time off. There’s, you know, a requirement that . . . traders have to take a certain amount of time off. So it’s really very hard to parse those two.

Q: And my question is really about your industry experience as well. Have you seen that before? Is that common?

A: I’ve never seen it. No, no. I’ve never seen it.⁵³

Pendergraft’s attempt to disclaim responsibility for Johnson’s supervision on regulatory matters also defies common sense. Under Pendergraft’s logic, supervisors could easily avoid liability simply by delegating “regulatory and compliance supervision” to others who may be far removed from the day-to-day activities of those they supervise. Moving the supervisor farther away from the day-to-day activities of their supervisee would increase the possibility of misconduct exponentially, as the supervisor would have less visibility to potential misconduct. Such a system would turn well-established supervision standards on their head and remove supervisory responsibility from those closest to—and most able to prevent and detect—potential misconduct.⁵⁴

3. The delegation was reasonable.

In addition to being clear and unequivocal, Yancey’s delegation of supervisory responsibility over Johnson to Pendergraft was reasonable. There is remarkably little in dispute about this. The delegation of supervisory responsibility is reasonable when: (1) the person to

⁵³ Poppalardo Test. at 1999:8-24; *see also* McCain Test. at 2203:10-17 (Prop. COL 41).

⁵⁴ “The evolution of the supervision standards is a triumph of common sense that makes oversight of the market more responsible, more accountable, and more practical.” *Bellows*, 1998 WL 409445, at *9.

whom the responsibilities are delegated possesses sufficient knowledge and experience to perform those functions in a satisfactory manner and (2) the person who has delegated supervisory responsibilities to another takes reasonable steps to ensure that the functions delegated are being performed in a reasonable manner.⁵⁵

Here, there is no dispute about the standard—the parties stipulated to it.⁵⁶ Second, the Division does not dispute that Pendergraft was qualified to supervise Johnson. The parties stipulated to this as well.⁵⁷ Third, there is no dispute that Yancey routinely and vigorously followed up on his delegation. Accordingly, Yancey's delegation of supervisory responsibility over Johnson to Pendergraft was reasonable.

a. It is undisputed that Pendergraft was qualified to supervise Johnson.

Pendergraft had sufficient knowledge and experience to supervise Johnson. The Division has stipulated to this fact.⁵⁸

b. Yancey consistently and actively followed up on Pendergraft's supervision of Johnson.

Follow up is reasonable where the delegator meets with the delegatee about the performance of the individual for whom supervisory responsibility was delegated and receives no indication of wrongdoing.⁵⁹ Similarly, evidence of reasonable follow up includes the delegator checking in with the delegatee regarding the performance of the individual for whom

⁵⁵ Stip. COL 9; *see also Bellows*, 1998 WL 409445, at *8.

⁵⁶ Stip. COL 9.

⁵⁷ Stip. FOF 82.

⁵⁸ Stip. FOF 82. (*See, e.g.,* Gover Test. at 178:18-179:15; Gardner Test. at 1153:2-12; Pendergraft Test. at 1526:23-1527:5; Yancey Test. at 1813:10-18).

⁵⁹ *See Universal Heritage Invs. Corp.*, 1982 WL 525157, at *2 (finding no failure to supervise where president of broker-dealer delegated supervisory authority to another and president "met with [delegatee] several times a month to discuss the firm's operations."); *In the Matter of Swartwood Hesse, Inc.*, 1992 WL 252184 at *5 (Sept. 22, 1992) (delegator not liable for failing to supervise when "the record does not show that, during the relevant period, [president] had the slightest indication of any irregularity in [supervisee's] activities, that any irregularity was brought to his attention, or that he had reason to believe he could not trust [delegates] to perform his functions in a proper manner").

supervisory responsibility was delegated. Neither of these two points are disputed—Paulukaitis and Poppalardo agree on both of these points.⁶⁰

And that is exactly what happened here. Pendergraft admitted that he and Yancey met regularly and discussed Johnson's performance in those meetings.⁶¹ Pendergraft further admitted that Yancey "routinely checked in" with him regarding his evaluation and review of Johnson's performance; his disciplining of Johnson; his approvals of Johnson's budget and compensation; his advice to Johnson on customer relations issues, business development plans, and customer client relation plans and budgets; his instructions to Johnson regarding PFSI firm financing and lending balances; and his approvals of Johnson's travel budget and expenses.⁶² Indeed, Pendergraft agreed that Yancey monitored his supervision of Johnson's activities and believed that Yancey acted reasonably in ensuring that Johnson and the stock lending group were properly conducting business in accordance with the securities laws.⁶³

⁶⁰ Paulukaitis Test. at 485:1-16 ("Q: . . . You would agree that if the delegator and the person to whom supervision was delegated had meetings to discuss that – that individual's performance, that would be evidence of the delegator taking reasonable steps to follow up on the delegation? A: That would be part of that process, yes. Q: And, for example, if the delegator had – was routinely checking in with the person to whom supervision had been delegated, that would be evidence of a delegator following up on the delegation? A: It could be, yes. Q: That's something you've seen in your experience? A: Yes."); Poppalardo Test. at 1990:25-1991:22 ("A: So if you -- if you have a wholesale delegation to another individual? Q: Right. A: . . . You know, you're delegating something because you believe that the person has the experience. . . you talk to the person and you decide that this person is going to carry out these responsibilities. And then once you've delegated, you have sort of an ongoing responsibility to make sure that that delegation is reasonable. And unless something comes to mind in your meeting with the person and there's an opportunity for you through your testing process and interactions to become aware of any problems that there might be . . . it's entirely appropriate.").

⁶¹ Stip. FOF 88; Pendergraft Test. at 1535:23-1536:1 ("A: I met with Mr. Yancey regularly and discussed Mr. Johnson's performance in some of those meetings."); *see also* 1536:21-1537 ("Q: . . . Do you agree that as a result of your regular conversations with Mr. Yancey that Mr. Yancey knew that you were involved in those kinds of activities with Mr. Johnson? A: I think that for the period of time that I was -- that Mr. Johnson reported to me, I believe that Mr. Yancey knew that I was involved in the activities that we discussed . . .").

⁶² Pendergraft Test. at 1537:5-10 ("Q: . . . Mr. Yancey routinely checked in with me regarding those activities, and I believe acted reasonably in ensuring that Mr. Johnson and the Stock Lending group were properly conducting business in accordance with the securities laws. A: I believe that.") (Prop. FOF 11).

⁶³ Pendergraft Test. at 1540:10-20 ("Q: In all of my dealings with Mr. Yancey he always placed compliance at the forefront of PFSI's business practices. A: Yes. Q: I observed him properly and diligently supervising the PFSI business by assigning responsibility as appropriate and following up. A: Yes, sir. Q: In that regard, I believe that Mr. Yancey acted as a reasonable CEO of a broker-dealer. A: Yes, sir, I believe that."); Pendergraft Test. at 1537:5-10 ("Q: Fair enough. Mr. Yancey routinely checked in with me regarding those activities, and I believe

Yancey's testimony corroborates Pendergraft's testimony. Yancey testified that after the delegation he and Pendergraft engaged in a pattern and practice of routine follow up to discuss Johnson's performance.⁶⁴ Yancey and Pendergraft talked at length about Johnson's performance and whether Johnson was meeting expectations.⁶⁵ Yancey also attended weekly meetings with Pendergraft and Johnson wherein Johnson reported in his capacity as global head of securities lending. This allowed Yancey to assess Pendergraft's interaction with Johnson on a weekly basis.⁶⁶ Additionally, Pendergraft kept a desk and computer in Yancey's office, which provided opportunities for Yancey and Pendergraft to discuss Johnson's performance.⁶⁷ These are precisely the types of activities that courts have found demonstrate reasonable delegation.⁶⁸

Thus, because it is undisputed that: (1) Pendergraft was qualified to supervise Johnson and (2) Yancey regularly followed up on the delegation, Yancey's delegation of supervisory responsibility over Johnson to Pendergraft was reasonable.⁶⁹

4. The Division's diversion tactics cannot change the fact that Pendergraft actively and comprehensively supervised Mike Johnson.

a. The erroneous supervisory matrix does not alter reality.

Balanced against the staggering amount of evidence discussed above is the near total lack of any evidence to contradict the fact that Yancey delegated supervisory responsibility over

acted reasonably in ensuring that Mr. Johnson and the Stock Lending group were properly conducting business in accordance with the securities laws. A: I believe that.”).

⁶⁴ Yancey Test. at 948:18 (“So I fully delegated it to him. He accepted that delegation. And then there became a pattern and practice of follow-up routine communication between Phil and I to ensure that -- that his supervision was adequate and -- and appropriate.”).

⁶⁵ Stip. FOF 88; Yancey Test. at 1859:7-14 (“Q: . . . What did you observe Mr. Pendergraft doing? A: . . . I saw him talking to Mike Johnson. I talked to Phil about Mike Johnson. I talked to Phil at length . . . Phil and I had discussions about had. . . this vision been fulfilling in the way that he anticipated.”).

⁶⁶ Yancey Test. at 948:23-950:23 (“Q: What did that pattern and practice look like? A: . . . he called on Mike Johnson, in every meeting, to offer a report in his capacity of global head of Securities Lending, and Mike Johnson always gave a report. And so I heard, on a weekly basis, the interaction between Mike and Phil.”).

⁶⁷ Stip. FOF 76; *see also* Delaney Test. at 1336:14-1337:3.

⁶⁸ *Universal Heritage*, 1982 WL 525157, at *2 (finding no failure to supervise where president of broker dealer delegated supervisory authority to another and president “met with [delegatee] several times a month to discuss the firm’s operations.”).

⁶⁹ Stip. COL 9; *see also Bellows*, 1998 WL 409445, at *8.

Johnson to Pendergraft. Instead, the Division bases its case against Yancey on a single erroneous document—the supervisory matrix. The Division argues that because the supervisory matrix states that Yancey was Johnson’s “regulatory supervisor,” then that must make it true. This argument fails for multiple, independent reasons.

First, the supervisory matrix was wrong. Kim Miller—the author of the document—could not have been more certain that the document was wrong:

Q: And do you see where it says Regulatory Supervisor, Bill Yancey?

A: Yes.

Q: Is that accurate?

A: I do not believe that’s accurate.

Q: Why don’t you believe that’s accurate?

A: Mr. Pendergraft holds a 24. So the regulatory supervision piece would not have transferred to Bill. It would have remained [with] Phil.⁷⁰

...

Q: But how clear are you, in your mind, that it’s not correct?

A: Very clear. There’s a couple of people on here that are—I know to be Penson Worldwide employees that did not report directly to Phil, and that Phil was their direct manager as well as their regulatory supervisor.⁷¹

...

Q: Do you think based on your personal experience at Penson, that it’s appropriate that Bill Yancey’s name be in the Pi Org Chart column?

A: No. It still states that Mike is a Penson Worldwide employee, which is where Phil’s—Phil’s company, but it’s in Worldwide, and so he should be under Phil.

Q: . . . Do you think that the document is wrong when it lists Bill Yancey as the Pi org chart and the regulatory supervisor for Michael Johnson?

A: In both columns, yes.⁷²

...

Q: If you had been asked by Mr. Warner in either of your prior two testimonies about who supervised Mike Johnson, what would you have told him?

A: He reported to Phil Pendergraft.

Q: And why do you say that?

A: Because he reported to Phil Pendergraft. He was a Worldwide employee, and Penson Worldwide employees typically reported to Phil Pendergraft.

Q: Is there any other basis that you have for that statement?

A: I mean, other than seeing him with Phil, that’s you know—not really, just knowing that he worked for Phil.

Q: And is that still your belief today?

⁷⁰ Miller Test. at 2594:13-21.

⁷¹ Miller Test. at 2595:19-25.

⁷² Miller Test. at 2601:25-2602:11.

A: Yes, sir.⁷³

Holly Hasty, Penson's Deputy Chief Compliance Officer—and Kim Miller's supervisor⁷⁴—corroborated Miller's testimony that the supervisory matrix was wrong.⁷⁵ As did Bart McCain, who testified that the supervisory matrix was replete with errors.⁷⁶ Furthermore, as demonstrated above, nearly a dozen witnesses testified that Phil Pendergraft—not Bill Yancey—was Mike Johnson's supervisor.

Second, there is no merit to the Division's argument that there was confusion within Penson about the supervisory structure and, therefore, Yancey retained supervisory responsibility over Johnson. The trial record is crystal clear—there was no confusion within Penson about who supervised Mike Johnson.⁷⁷ Nor did the erroneous supervisory matrix foster confusion within Penson because nobody within the firm relied on the document.⁷⁸

The Division relies on *In the Matter of Angelica Aguilera* to support its argument that an erroneous supervisory matrix subjects Yancey to liability.⁷⁹ But that case is inapposite and

⁷³ Miller Test. at 2585:9-23.

⁷⁴ Hasty Test. at 1725:12-15 (“Q: Okay. And who -- I think you said that Kim Miller didn't report to you early on, but by this point, was she reporting to you? A: Yes, she was.”) (Prop. FOF 103).

⁷⁵ Hasty Test. at 1794:12-1795:8 (“Q: In fact, it is an error that Bill Yancey is listed as Mike Johnson's supervisor in any capacity? A: I would agree with that, yes. . . Q: Why do you believe that that is an error? A: I sat in the location where the Stock Loan folks were for a period of time. I mean, Mike Johnson is not a quiet person. He was very vocal about who he reported to and where he got his directions and how, if something were to come up, who he was going to take his orders from. And so looking at all of these documents is all well and good, but at the end of the day, my own personal perception and observations of Mike Johnson and his own admission that he reported to Phil is what makes it clear to me.”) (Prop. FOF 16).

⁷⁶ McCain Test. at 2190:6-2191:24 (identifying errors in the supervisory matrix); *see also* Yancey Test. at 1930:10-1932:22 (identifying errors in the supervisory matrix) (Prop. FOF 16).

⁷⁷ Gardner Test. at 1153:24-1154:2 (“Q: Ms. Gardner, are you aware of anyone in the company that was confused about who supervised Mike Johnson? A: No.”); McCain Test. at 2194:9-16 (“Q: In your mind, was there any confusion about who Mike Johnson reported to? A: Absolutely not.”); Hasty Test. at 1745:13-16 (“Q: Are you aware of anyone at the Penson organization who was confused about who Mike Johnson was supervised by? A: No.”); Delaney Test. at 1336:10-13 (“Q: To your knowledge, Mr. Delaney, was there anyone in the Penson organization who was confused about who Mr. Johnson's supervisor was? A: No.”) (Prop. FOF 18).

⁷⁸ Hasty Test. at 1747:20-25 (“Q: Is this a document that you relied on to know who someone's supervisor was? A: No. Q: Is this a document that you used in your day-to-day compliance responsibilities? A: No.”); Delaney Test. at 1345:2-11 (Q: Was the Supervisory Matrix . . . used in your day-to-day operation to know who was the supervisor of another? A: No. Q: Are you aware of anyone at Penson who used that particular document, this Registered Representative Supervisory matrix, to understand who was someone's supervisor? A: No.”) (Prop. FOF 7).

⁷⁹ Division Closing at 2667:10-25.

easily distinguishable. In *Aguilera*, two employees of a broker-dealer willfully violated Section 17(a) by engaging in a scheme to defraud investment funds by charging them excessive markups on structured note transactions.⁸⁰ There was substantial evidence that Aguilera, the firm's president, knew about the misconduct, including the fact that she failed to disclose a relationship between one of her senior brokers and another broker-dealer.⁸¹ The court found that Aguilera failed reasonably to supervise the employees primarily because she took no steps to supervise trading and "failed in her duty to follow up on" a purported delegation.⁸² In support of this conclusion, the court noted that the firm's WSPs were "a complete mess," Aguilera knew the WSPs were a complete mess, Aguilera took inadequate steps to correct the WSPs, and Aguilera admitted that she accepted supervisory responsibilities that were "beyond [her] capabilities."⁸³

Aguilera is easily distinguishable. First, unlike the circumstances in *Aguilera*, there was no confusion within Penson about who supervised Johnson. Nearly a dozen witnesses testified that Phil Pendergraft unquestionably supervised Johnson. Second, in *Aguilera*, the firm's president *knew* that the WSPs were "a complete mess" and still failed to correct them.⁸⁴ Here, in contrast, Yancey did not know that the supervisory matrix was wrong because, like many others within Penson, he did not review or rely on the document.⁸⁵ Third, in *Aguilera*, there was substantial evidence that Aguilera knew about the ongoing misconduct.⁸⁶ Here, in contrast, not only has the Division stipulated that Yancey knew nothing about the Rule 204(a) violations, the

⁸⁰ *In the Matter of Angelica Aguilera*, SEC Admin. Proc. File 3-14999, Initial Decision Release No. 501, 2013 WL 3936214, at *21 (July 31, 2013).

⁸¹ *Id.* at **12-13.

⁸² *Id.* at *26.

⁸³ *Id.* at *27.

⁸⁴ *Id.* at *27.

⁸⁵ Yancey Test. at 1837:24-1839:12 ("... Q: Had you ever seen [the supervisory matrices] prior to this proceeding being initiated? A: Not that I recall. Q: Did anybody ever tell you how it was used. . . ? A: No. Q: Do you have any belief as you sit here as to why you didn't read or review the e-mails with those matrices attached? A: . . . I can only speculate why . . . since I don't remember them. But I thought that they had something to do with licensing and registration. . . Q: Were you aware that the matrix was ever sent to regulators? A:. . . At the time, I didn't know its primary use. . . ") (Prop. FOF 7).

⁸⁶ *Aguilera*, 2013 WL 3936214, at **12-13.

Division asserts that the violations were actively concealed from him. Fourth, unlike in *Aguilera*—where there was no evidence that Aguilera followed up on the delegation—Yancey irrefutably followed up on the delegation and never received even the slightest indication that Stock Loan was not complying with Rule 204(a). Indeed, Pendergraft admits this fact.⁸⁷

Third, the law is well-established that determining if a particular person is a supervisor depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue.⁸⁸ As both the Division's and Yancey's experts testified, no one piece of evidence—including the supervisory matrix—is dispositive in identifying a person's supervisor.⁸⁹ Both experts agreed that the supervisory matrix is simply *one fact* that could evidence supervisory authority.⁹⁰ When balanced against the overwhelming evidence supporting Yancey's delegation of supervisory responsibility over Johnson to Pendergraft, the erroneous supervisory matrix does not come close to meeting the Division's burden of proof.

Fourth, the fact that the supervisory matrix was sent to regulators cannot change the fact

⁸⁷ Stip. FOF 88; Pendergraft Test. at 1535:23-1536:1 (“A: I met with Mr. Yancey regularly and discussed Mr. Johnson's performance in some of those meetings.”); 1537:5-10 (“Q: Fair enough. Mr. Yancey routinely checked in with me regarding those activities, and I believe acted reasonably in ensuring that Mr. Johnson and the Stock Lending group were properly conducting business in accordance with the securities laws. A: I believe that.”).

⁸⁸ *Gutfreund*, 51 S.E.C. 93, 113.

⁸⁹ *Swartwood*, 1992 WL 252184, at *5 (“the fact that there was no written documentation to support this division of authority is not dispositive of the issue”); *Raymond James*, 2005 WL 2237628 at * 47 (“The fact that [broker dealer's] CEO did not formally delegate to [delegatee] responsibility for the design, adoption and implementation of [broker dealer's] supervisory procedures does not change the fact that [delegatee] was responsible for supervising [supervisee]. [Delegatee] controlled [supervisee's] activities,” and was responsible for hiring and firing supervisee); Paulukaitis Test. at 485:24-489:19 (“Q: You would agree with me that in performing a facts and circumstances analysis, you would need to consider all of the facts and circumstances, including who the person is, what their background is, what their position is, what their authority is, what they're being told to do -- all of those factors would have to be mixed together and analyzed; is that fair? A: In terms of what? Q: In terms of determining who somebody's supervisor is. A: Yes.”); Poppalardo Test. at 2040:21-2041:1 (“Q: . . . Do you believe those matrices are determinative of who is a supervisor? A: No, I don't, and I think it's clear based on administrative decision, case law, that it's a fact and circumstances determination.”).

⁹⁰ Paulukaitis Test. at 487:22-25 (“Q: . . . The WSPs are one fact and circumstance that may evidence supervisory authority; is that fair? A: Yes.”); Poppalardo Test. at 2040:21-2041:1 (“Q: . . . Do you believe those matrices are determinative of who is a supervisor? A: No, I don't, and I think it's clear based on administrative decision, case law, that it's a fact and circumstances determination.”).

that Pendergraft was comprehensively supervising Johnson. As Ms. Poppalardo testified, supplying the erroneous supervisory matrix to regulators did not magically morph Yancey into Johnson's supervisor:

- Q: Ms. Atkinson asked you about several supervisory matrices. Do you believe those matrices are determinative of who is a supervisor?
- A: No, I don't, and I think it's clear based on administrative decision case law that it's a fact and circumstances determination.
- Q: If a supervisory matrix is given to FINRA or CBOE designating, as these do, of regulatory supervisors, what does that say about who has day-to-day responsibility for supervision?
- A: It doesn't say anything. It fulfills the requirement that FINRA has in its rules that say you have to have a designated supervisor over each business line.
- Q: And is that matrix that's given to the regulator determinative of who is a supervisor for day-to-day purposes?
- A: No. Again, it would depend on a lot of other things.⁹¹

Moreover, there is no evidence that any regulator was ever confused about Penson's supervisory structure. And even if they were, that is immaterial to the claim against Yancey. The relevant question is whether employees within *Penson* were confused about the supervisory structure. The evidence conclusively establishes they were not.⁹²

b. Johnson had one supervisor—Pendergraft.

Undoubtedly recognizing the flaws in its original theory, the Division has pivoted to the argument that Johnson had two supervisors, Pendergraft *and* Yancey. The Division posits that Yancey was responsible for supervising Johnson's PFSI-related activities, and Pendergraft was responsible for supervising Johnson's PWI-related activities.⁹³ This argument is meritless. Indeed, even Pendergraft rebuked this theory.

⁹¹ Poppalardo Test. at 2040:21-2041:14 (Prop. FOF 27).

⁹² Gardner Test. at 1153:24-1154:2 ("Q: Ms. Gardner, are you aware of anyone in the company that was confused about who supervised Mike Johnson? A: No."); McCain Test. at 2194:9-16 ("Q: In your mind, was there any confusion about who Mike Johnson reported to? A: Absolutely not."); Hasty Test. at 1745:13-16 ("Q: Are you aware of anyone at the Penson organization who was confused about who Mike Johnson was supervised by? A: No."); Delaney Test. at 1336:10-13 (Prop. FOF 102).

⁹³ Tellingly, this theory is not in the OIP or in the Division's expert reports. Rather, the Division asserted this theory for the first time in its pre-hearing brief (see Prop. FOF 43).

First, none of Penson's organization charts reflect Johnson as reporting to Pendergraft *and Yancey*. After August 2008, the organization charts unequivocally demonstrate that Johnson no longer reported to Yancey.⁹⁴ Nor do the organization charts reflect that Johnson had dotted line responsibility to Yancey.

Second, none of the email communications support the Division's two-supervisor theory; rather, the email communications between Pendergraft and Johnson overwhelmingly demonstrate that Pendergraft was Johnson's lone supervisor.

Third, none of the testimony supports the Division's two-supervisor theory. As Dawn Gardner testified, Johnson had one supervisor, and that supervisor was Pendergraft:

- Q: Are you familiar, Ms. Gardner, with the concept of dual reporting?
A: Yes,
Q: What does dual reporting mean to you?
A: When someone reports to more than one Manager, two Managers.
Q: During this time period that we have been talking about, after August 2008, did Mike Johnson have . . . dual reporting to anybody?
A: No.
Q: [H]e had one supervisor?
A: Yes.
Q: And who was that supervisor?
A: Phil Pendergraft.
Q: What about dotted line? Did Mike Johnson have dotted line reporting to anyone?
A: No.
Q: If Mike Johnson had had more than one supervisor, would you have known about it?
A: Yes.⁹⁵

Holly Hasty, the Deputy Chief Compliance Officer, similarly testified that Pendergraft was Johnson's only supervisor:

- Q: Is there any chance that Mr. Johnson had two supervisors?
A: No.
Q: If he did, would you have known about it?
A: Yes.
Q: Is that based on your position in the Compliance Department?

⁹⁴ See, e.g., Ex. 571 (organizational chart).

⁹⁵ Gardner Test. at 1151:12-25 (Prop. FOF 28).

A: Yes.⁹⁶

And even Johnson—the individual being supervised—confirmed that he had only one supervisor:

Q: And during that period of time, did you only have one supervisor, and was that either Mr. Phil Pendergraft or Mr. Dan Son?

A: Yes.

Q: And you told [the Division lawyers] that?

A: I believe so.⁹⁷

The trial record overwhelmingly establishes that Yancey reasonably and appropriately delegated supervision of Johnson to Pendergraft. The Court should dismiss the Division's failure to supervise claim.

B. Alternatively, the Division's supervisory claim against Yancey fails because Johnson was reasonably supervised.

Dismissal is also proper because *Johnson was reasonably supervised*, either by Pendergraft, or Yancey in connection with his follow-up of Johnson's supervision.

1. Pendergraft reasonably supervised Johnson.

The fact that Pendergraft supervised Johnson is so clear that no contrary position is colorable. As established above, Pendergraft: evaluated and reviewed Johnson's performance; disciplined Johnson; approved Johnson's budget and compensation; could overrule or override Johnson's decisions; advised Johnson on customer relations issues, business development plans, and customer client relation plans and budgets; instructed Johnson regarding PFSI firm financing and lending balances; and he approved Johnson's travel budget and scrutinized his expenses. Pendergraft also reprimanded Johnson regarding internal policies and regulatory issues; directed Johnson to meet with regulators; consulted with Johnson about Rule 204 issues; and provided guidance to Johnson about Reg SHO. Pendergraft performed all of these activities within the

⁹⁶ Hasty Test. at 1745:5-12 (Prop. FOF 28).

⁹⁷ Johnson Test. at 537:25-538:5 (Prop. FOF 28).

context of Johnson's responsibilities for the Stock Lending department of PFSI for Penson's U.S. operations.⁹⁸ In sum—under any legal test—Pendergraft supervised every material aspect of Johnson's job.

Accordingly, this is not a case where an employee was left on his own unsupervised. Rather, Pendergraft comprehensively supervised all of Johnson's PFSI-related activities. That the Stock Loan department failed consistently to close out failures to deliver on long sales of loaned securities by market open does not automatically mean that there was a failure to supervise.⁹⁹ "A firm's President is not automatically at fault when other individuals in the firm engage in misconduct of which he has no reason to be aware."¹⁰⁰ The Division has done nothing more than establish that violations occurred—the Division has not (and cannot) demonstrate that there was a failure to supervise because Pendergraft was reasonably supervising Johnson.

2. Yancey's follow up provided reasonable supervision of Johnson.

The Division's claim fails for another, independent reason. Even if Yancey could be held liable for failing to supervise Johnson—despite the fact that Pendergraft was supervising Johnson—the Division's claim fails because Yancey's regular and robust follow up of Pendergraft's supervision provided reasonable supervision of Johnson.

It is undisputed that Yancey reasonably followed up on Pendergraft's supervision of Johnson. As demonstrated above, Yancey met regularly with Pendergraft and discussed Johnson's performance in those meetings. Yancey also "routinely checked in" with Pendergraft

⁹⁸ Pendergraft Test. at 1536:21-1537:4; *see also* 1528:5-1534:9.

⁹⁹ *In the Matter of IFG Network Sec., Inc.*, Exchange Act Release No. 34-54127, 88 SEC Docket 1195, 2006 WL 1976001 (July 11, 2006) (where Division proved underlying violation against supervisee, it failed to prove failure to supervise claim against supervisor where supervisor put procedures in place that could reasonably have been expected to prevent the underlying violations); *In the Matter of Charles F. Kirby*, SEC Admin. Proc. File No. 3-9602, Initial Decision No. 177, 2000 WL 1787908 *20-23 Dec. 7, 2000 (where Division proved underlying violation against supervisee, it failed to prove failure to supervise where supervisor acted reasonably and had no reason to suspect that supervisee was violating securities laws).

¹⁰⁰ *Swartwood*, 1992 WL 252184 at *6.

regarding: his evaluation and review of Johnson's performance; his disciplining of Johnson; his approvals of Johnson's budget and compensation; his advice to Johnson on customer relations issues, business development plans, and customer client relation plans and budgets; his instructions to Johnson regarding PFSI firm financing and lending balances; and his approvals of Johnson's travel budget and expenses. Yancey monitored Pendergraft's supervision of Johnson's activities. And Yancey also attended weekly meetings with Pendergraft and Johnson, which allowed Yancey to receive weekly updates regarding the stock loan department. Pendergraft himself admitted that Yancey acted reasonably in ensuring that Johnson and the stock lending group were properly conducting business in accordance with the securities laws.¹⁰¹

Thus, Johnson did not go unsupervised—Yancey reasonably supervised Johnson by virtue of his consistent follow up.¹⁰²

II. The Division Did Not Prove that Yancey Failed to Supervise Tom Delaney.

A. The Division's supervisory claim against Yancey fails as a matter of law because the Division failed to prove that Delaney aided and abetted an underlying violation of the securities laws.

The Division did not meet its burden to prove that Delaney aided and abetted a "policy and practice of intentionally and consistently" violating Rule 204(a) with respect to long sales of loaned securities.¹⁰³ This is fatal to the Division's supervisory claim against Yancey.¹⁰⁴ The trial evidence demonstrated that Delaney was a conscientious, qualified, and engaged CCO, that

¹⁰¹ Pendergraft Test. at 1540:10-20 ("Q: In all of my dealings with Mr. Yancey he always placed compliance at the forefront of PFSI's business practices. A: Yes. Q: I observed him properly and diligently supervising the PFSI business by assigning responsibility as appropriate and following up. A: Yes, sir."); 1537:5-10.

¹⁰² *Cf. Urban*, Initial Decision Release No. 402 at 52-55 (finding no delegation but finding no failure to supervise because respondent reasonably supervised individual whose conduct was at issue).

¹⁰³ OIP at ¶¶ 85-86; *see also* Division's Opp. to Resp. Yancey's Mot. to Identify Rule 204(a) Violations at 5 ("... this case focuses on a systematic, intentional practice of violating Rule 204(a)").

¹⁰⁴ *In the Matter of Bresner*, Exchange Act Release No. 34-68464, 2012 WL 6608195, at *2 (Dec. 18, 2012) (denying as inefficient a request to sever action against supervisor and representative because, "as in all failure-to-supervise cases, the underlying violation must be proven as the first step in substantiating a charge of supervisory failure against [the supervisor]"); *IFG Network Sec.*, 2006 WL 1976001 ("Since the alleged violations of the three registered representatives are unproved, it must be concluded that the failure to supervise charge against IFG and Ledbetter is also unproved.") (Prop. COL 4); (Prop. COL 2).

he was unaware of any Rule 204(a) violations relating to long sales of loaned securities prior to February 2011, and he lacked the scienter necessary to prove his alleged aiding and abetting. Accordingly, the Division's claim against Yancey should be dismissed.

B. Alternatively, the Division failed to prove that Yancey did not reasonably supervise Delaney.

The Division's claim also fails because the Division did not carry its burden to prove Yancey *failed reasonably* to supervise Delaney. Rather, the evidence demonstrates precisely the opposite—Yancey was an active, engaged supervisor and a champion of compliance who did not know—and had no reason to know—that the Stock Loan department was not consistently closing out failures to deliver on long sales of loaned securities by market open.

1. Yancey had no knowledge of intentional Rule 204(a) violations.

It is undisputed that Yancey had *no knowledge* of intentional Rule 204(a) violations by the Stock Loan department.¹⁰⁵ While neither scienter nor willfulness is an element of a failure to supervise charge, “scienter may be considered in evaluating the reasonableness of supervision.”¹⁰⁶ Accordingly, this stipulated fact weighs heavily in favor of a finding that Yancey reasonably supervised Delaney.¹⁰⁷

2. Yancey reasonably supervised Delaney.

The trial record indisputably establishes that Yancey's supervision of Delaney vastly exceeded the reasonableness standard. Nearly every trial witness—including the Division's own witnesses—testified that Yancey was an engaged, accessible, ethical, and honest CEO.¹⁰⁸ His

¹⁰⁵ Stip. FOF 43.

¹⁰⁶ *In the Matter of Angelica Aguilera*, Initial Decision Release No. 501, 25; *In the Matter of Clarence Z. Wurts*, 54 S.E.C. 1121, 1132 (Jan. 16, 2001) (Prop. COL. 3).

¹⁰⁷ See *Charles F. Kirby*, 2000 WL 1787908, at *20-23 (where supervisor had no reason to suspect supervisee was violating securities laws, such fact weighed in favor of finding supervision was reasonable).

¹⁰⁸ Delaney Test. at 1339:23-1340:1 (“Q: Was Mr. Yancey an accessible supervisor? A: He was. Q: Was he an engaged supervisor? A: He was.”); Hasty Test. at 1701:25-1702:8 (“A: . . . he was always present at different meetings that we would have, and he was always very engaged. . . .”); Wetzig Test. at 423:16-424:3 (“Q: Was he

leadership fostered a culture of open communication, accountability, and integrity.¹⁰⁹ He promoted an environment of compliance through his words and his actions, including the exhaustive allocation of resources to fund and expand compliance efforts.¹¹⁰

Yancey's supervision was constant, comprehensive, and effective. Yancey met with all of his direct reports—including Delaney—twice a week in both group and one-on-one meetings,¹¹¹ which allowed him to stay abreast of the firm's important issues and fostered an open dialogue between members of the management team.¹¹² Yancey routinely communicated with Delaney regarding compliance updates, the results of internal testing, remediation efforts, and regulatory examinations.¹¹³ Delaney considered Yancey to be more than just a manager or

engaged? A: Yes, sir, he was."); McCain Test. at 2178:5-7 ("Bill was a - - a very involved manager."); *see also* Alaniz Test. at 837:8-18; Gover Test. at 176:18-177:9 (Prop. FOF 30); *see also* Miller Test. at 2603:11-23 ("Q: Do you think Mr. Yancey -- in your experience, was he an honest man? A: Yes. Q: What -- in your own words, describe your views of Mr. Yancey. A: Any conversation that I ever had with Bill was always about doing the right thing. There was never a conversation that I had with him where he even missed a beat on making the right decision. He's a good man."); Gover Test. at 176:18-177:6; Wetzig Test. at 423:19-424:5; Delaney Test. at 1328:13-15; Pendergraft Test. at 1483:18-1484:2 Hasty Test. at 1753:6-9 (Prop. FOF 85).

¹⁰⁹ *See, e.g.*, Pendergraft Test. at 1483:18-1484:2 (discussing when he hired Yancey, "We wanted someone who had a passion for excellence, who had a passion for people, had a passion for integrity. . . we were hiring someone we thought could be a great leader of the organization.") (Prop. FOF 85); *see also* Hasty Test. at 1701:25-1702:8; Wetzig Test. at 423:16-424:3; Alaniz Test. at 837:8-18; Gover Test. at 176:18-177:9) (Prop. FOF 30).

¹¹⁰ Stip. FOF 72; *see also* Delaney Test. at 1340:17-24 ("A: When I started with the Compliance department, it was about a team of five or so, and at our high point we had over 25 compliance associates that were in that department. It was a meaningful -- it was a meaningful addition to -- to staff. We had implemented a very, very expensive compliance system. . . Bill Yancey approved that without blinking an eye."); Alaniz Test. at 840:21-840:23 ("Q: And did Bill Yancey fully support that increase to the Compliance department? A: Everything I heard, the answer would be yes.") (Prop. FOF 36).

¹¹¹ Stip. FOF 95; *see also* Delaney Test. at 1339:1-19 ("Q: Did he meet with you regularly? . . . A: As part of a rigor, at least a couple times a week, but in many cases more than that . . . Q: Did Mr. Yancey have a routine group meeting of all his direct reports? A: He did."); Yancey Test. at 1840:9-14 ("Q: What was your approach in terms of supervising the people who were your direct reports . . . A: I set up a one-on-one with them, and then I held a regular Tuesday morning at 9:00 a.m. staff meeting for my direct reports every week."); McCain Test. at 2178:14-25 (Prop. FOF 23); Delaney Test. at 1339:23-1340:1 ("Q: Was Mr. Yancey an accessible supervisor? A: He was. Q: Was he an engaged supervisor? A: He was."); *see also* Hasty Test. at 1701:25-1702:8; Wetzig Test. at 423:16-424:3; McCain Test. at 2178:5-7 (Prop. FOF 30).

¹¹² Yancey Test. at 1918:25-1919:11 ("A: The -- the meetings were the same. I opened. I gave them an update. I gave them information that I thought they would benefit from knowing, and I then went around the room and I asked each of them for an update. . . And depending on the things that were going on, I fully asked everybody, question people, ask questions."); *see also* Delaney Test. at 1339:23-1340:1; Hasty Test. at 1701:25-1702:8; Wetzig Test. at 423:16-424:3; McCain Test. at 2178:5-7 (Prop. FOF 30).

¹¹³ *See* Stip. FOF 95; Delaney Test. at 1339:1-5 ("Q: Did he meet with you regularly? . . . A: As part of a rigor, at least a couple times a week, but in many cases more than that."); Yancey Test. at 1840:9-14 ("Q: What was your approach in terms of supervising the people who were your direct reports . . . A: I set up a one-on-one with them,

supervisor.¹¹⁴ Yancey was a mentor who provoked meaningful leadership and challenged Delaney and his other direct reports to become better managers, leaders, and contributors to PFSI.¹¹⁵

3. The Division failed to prove that any “red flag” should have alerted Yancey to systematic and intentional violations of Rule 204(a) for long sales of loaned securities.

The Division’s entire case against Yancey rests on four purported “red flags,” which the Division argues should have alerted Yancey to a policy and practice of intentional violations regarding long sales of loaned securities: (1) results of the December 2009 Rule 204 Audit (the “December 2009 Audit”); (2) Michael Johnson’s absence from a March 31, 2010 meeting; (3) Penson’s March 31, 2010 CEO certification; and (4) Penson’s November 2010 response to OCIE’s Reg SHO exam.¹¹⁶ All four of these purported “red flags” arise from the December 2009 Audit.¹¹⁷ At trial, the Division seemingly abandoned two of these red flags – Johnson’s “absence” from a March 31, 2010 meeting and Penson’s November 2010 response to OCIE. Notwithstanding that the Division previously characterized these two purported “red flags” as “emergency flare[s]” and “beacon[s],”¹¹⁸ the Division did not ask Johnson or Gover—the centerpieces of these two purported “red flags” and the Division’s own witnesses—a single question about these events.¹¹⁹

and then I held a regular Tuesday morning at 9:00 a.m. staff meeting for my direct reports every week.”) (Prop. FOF 23); *see also* Yancey Test. at 882:23-883:11 (Prop. FOF 35).

¹¹⁴ Delaney Test. at 1328:13-17 (“A: . . . Mr. Yancey is a -- he exhibits a lot of integrity. He's an honest man. He's been a mentor. . . a friend of the Compliance department . . I am proud to know Mr. Yancey.”) (Prop. FOF 62).

¹¹⁵ Delaney Test. at 1369:7-14 (“A: Mr. Yancey is more than just a manager or a supervisor. He -- he -- he provokes meaningful thought leadership and really presses me and had pressed me throughout my time at Penson to be a better -- to be a better manager, to be a better leader, to be a better contributor to the organization.”) (Prop. FOF 62).

¹¹⁶ *See* OIP at ¶¶ 74-83.

¹¹⁷ OIP at ¶ 74 (“December 2009 audit”); ¶ 75 (“meeting regarding the December 2009 audit”); ¶ 80 (“omission of any discussion relating to the December 2009 audit”); ¶ 82 (“false in light of the December 2009 audit”).

¹¹⁸ OIP at ¶¶ 80, 83.

¹¹⁹ Tellingly, the Division chose not to question Mr. Johnson regarding his attendance at the March 31, 2010 meeting. *See* Johnson Test. at 513-568 (Prop. FOF. 76). The Division also chose not to question Mr. Gover regarding the OCIE response language that he authored. *See* Gover Test. at 74-198 (Prop. FOF 81).

A. The December 2009 Audit was not a red flag.

The Division concedes that the December 2009 Audit did not test the transactions that are at issue in this case—long sales of loaned securities.¹²⁰ Thus, it is undisputed that nothing in the December 2009 Audit—nor anything communicated to Yancey regarding the audit—revealed any Stock Loan department Rule 204(a) violations regarding long sales of loaned securities.¹²¹

Because the December 2009 Audit did not test Stock Loan’s procedures related to long sales of loaned securities, the Division tries to fit a square peg into a round hole. The Division alleges that there was a “direct nexus” between the Buy Ins’ and Stock Loan departments’ Rule 204(a) procedures and, therefore, issues identified regarding the Buy Ins department *should have* alerted Yancey to issues with the Stock Loan department.¹²² But the trial record establishes otherwise.

First, as multiple witnesses acknowledged, Penson’s Buy Ins department and Penson’s Stock Loan department had separate and distinct obligations regarding Rule 204 compliance.¹²³ The Buy Ins department handled close out obligations arising from fails on long and short sales caused by Penson’s customers.¹²⁴ Penson’s Stock Loan department, on the other hand, handled close out obligations arising from “long sales of loaned securities.”¹²⁵ The two departments were

¹²⁰ Stip. FOF 78.

¹²¹ Stip. FOF 40, 43, 77.

¹²² OIP at ¶ 74.

¹²³ See Stip. FOF 17 (Penson’s Buy-Ins department handled close-outs of CNS failures to deliver resulting from transactions initiated by customers); see also DeLaSierra Test. 305:6 - 306:3 (“Q: . . . You can have sales caused by a customer short; is that right? A: Yes. Q: And then you can have sales caused by a customer long sale where the customer fails to deliver; is that right? A: Correct. Q: . . . You agree that the buy-ins department had sole responsibility for closing out those fail to delivers? . . . Customer shorts and longs? A: Yes. Q: Okay. And then you would agree that Stock Loan, your department, had a separate responsibility for closing out long sales due to loaned securities? A: Correct.”) (Prop. FOF 70) (Prop. FOF 72).

¹²⁴ Stip. FOF 17 (DeLaSierra Test. 305:6-306:3).

¹²⁵ DeLaSierra Test. at 305:25-306:3 (“Q: And then if the fail arose from -- because of a long sale of a loan security, that was Stock Loan’s obligation, correct? A: That is correct.”) (Prop. FOF 70).

located on different floors, had different managers, and were staffed by different personnel.¹²⁶

Second, the Division's own witnesses flatly contradicted the Division's "nexus" theory.¹²⁷ Brian Gover, Vice President of Operations at Penson and one of the Division's witnesses, flatly rejected the Division's "nexus" theory:

Just because there were issues in the buy-ins group of getting the executions done on time does not mean that there were issues in Stock Loan They're separate.

If you're saying given the audit around the buy-in's piece, no, I don't think that would have given rise to a reasonable inquiry of the Stock Loan.¹²⁸

Eric Alaniz, another one of the Division's witnesses (and the individual responsible for conducting the audit), agreed that there was no merit to the Division's "nexus" argument.¹²⁹

Third, other witnesses confirmed that issues with the Buy Ins department would not be indicative of issues in the Stock Loan department. Delaney confirmed this point:

Q: Now, Mr. Alaniz's audit tested the buy-ins department. The Division is alleging that . . . there was a direct nexus . . . do you believe that an audit of a department that did not test whether there were failures to close out on long sales of loaned securities could ever be a red flag about failures to close out long sales of loaned securities in the Stock Loan Department?

A: No.

¹²⁶ Stip. FOF 86 (Delaney Test. at 1348:20-1349:17) ("Q: . . . let's talk about the buy-ins department and the Stock Loan Department. Those were two different departments at Penson, right? A: Yes, they were. Q: Were they on different floors? A: Yes. Q: Was buy-ins on the 9th floor? A: The 14th floor. . . . And was Stock Loan on the 9th floor? A: The 19th. Q: . . . They were five floors apart, fair? A: Fair. Q: Did they have different managers? Different department managers? A: They did. Q: Did they have different personnel within the departments? A: Yes. Q: Okay. They were two different functions of the Penson organization? A: Yes."); *see also* Stip. FOF 105, 106 109, 110.

¹²⁷ *See* Gover Test. at 172:22-174:21 ("A: . . . Just because there were issues in the buy-ins group of getting the executions done on time does not mean that there were issues in Stock Loan or were not issues in Stock Loan. They're separate."); 175:14-21 ("A: . . . If you're saying given the audit around the buy-in's piece, no, I don't think that that would have given rise to a reasonable inquiry of the Stock Loan."); DeLaSierra Test. 305:6 - 306:3 (stating that Stock Loan had a separate responsibility for closing out long sales due to loaned securities than that of the Buy-Ins department); Alaniz Test. at 855:11-856:12 (agreeing that, given the information he received from the various departments, it was not necessary to go to the Stock Loan Department or expand the test outside of buy-ins); *see also* Delaney Test. at 1348:19-23, 1351:10-17 ("Q: . . . Mr. Alaniz's audit tested the buy-ins department. . . . do you believe that an audit of a department that did not test whether there were failures to close out on long sales of loaned securities could ever be a red flag about failures to close out long sales of loaned securities in the Stock Loan Department? A: No. Q: . . . you did not see a nexus - - A: No") (Prop. FOF 15).

¹²⁸ Gover Test. at 174:17-21; 175:19-21 (Prop. FOF 15).

¹²⁹ Alaniz Test. at 855:23-856:12 ("Q: Would it be a fair assumption for Mr. Delaney and Mr. Yancey to similarly think that they would just be satisfied with the results of your testing and they would not need to go to another department to look? A: Based on all the information I was given from the departments, I don't believe that that was necessary - that it would have been necessary.") (Prop. FOF 15).

Q: . . . you did not see a nexus?
 A: No, sir. . . .
 Q: Mr. Alaniz did not see a nexus; is that fair?
 A: That's fair. . . .
 Q: How could Mr. Yancey?
 A: I don't believe he could.¹³⁰

Fourth, the Division's characterization of the audit results as reflecting a "99% violation rate" was also debunked by its own witnesses.¹³¹ Alaniz testified that he never used that term with Yancey in the January meeting.¹³² Gover testified that given Penson's trading volume,¹³³ the multi-step Rule 204(a) compliance processes,¹³⁴ and the narrow slice of securities tested,¹³⁵ labeling the audit results as a "99% violation rate" would be misleading and inaccurate. Indeed, Penson cleared between 13 to 15 million trades over the period of time that the December 2009 Audit tested.¹³⁶ The December 2009 Audit identified 112 total transactions that resulted in fail to deliver positions that were not timely closed out.¹³⁷ In the context of the volume of trades that Penson was successfully clearing, these results would not have been a "red flag" to any CEO, particularly where the CEO is promptly assured that remediation efforts were underway.¹³⁸

¹³⁰ Delaney Test. at 1351:6-25 (Prop FOF 15).

¹³¹ OIP at ¶ 74.

¹³² Alaniz Test. at 844:21-845:2 ("Q: . . . did you or Mr. Delaney use the phrase 99 percent fail rate? . . . A: I don't recall that we discussed that percentage.") (Prop. FOF 71); *see also* Ex. 70 (Prop. FOF 75).

¹³³ Gover Test. at 165:19-166:4 ("Q: How many trades do you think Penson cleared on a daily basis? A: I had seen them between three and five million.") (Prop. FOF 73).

¹³⁴ Gover Test. at 166:8-12 (testifying that at least 99%, of trades, if not more, settled on time); 167:11-20 ("Q: If it's T+4, morning of T+4 before market open, what percentage of the T+4 fails to deliver do you think Stock Loan was able to borrow to cover for? A: It was -- it was a high percent. We did not have to send very many orders to the execution desk to be bought in."); *see also* Wetzig Test. at 387:2-388:4; 389:3-10 ("Q: Do you know -- do you have any idea of the rate at which . . . the CNS position cleared up. I apologize. A: I would say that -- 98 percent. Q: 98 percent. Would you be surprised if it was actually higher? A: I would not.") (Prop. FOF 42).

¹³⁵ Gover Test. at 169:23-170:10 ("Q: Right. They can say whatever they want and kind of point to that last final piece of the buy-ins as saying, look, that was a high fail rate. But is it fair to say that the overall picture on the number of trades that you're claiming, that it was actually a fairly small number? A: Yeah.") (Prop. FOF 74).

¹³⁶ Ex. 70 at 2 (test conducted over a 10-day period); Gover Test. at 165:19-166:4 ("Q: How many trades do you think Penson cleared on a daily basis? A: I had seen them between three and five million.") (Prop. FOF 73).

¹³⁷ *See* Ex. 70.

¹³⁸ *See* Gover Test. at 111:20-23 ("A: . . . It was mechanics. It wasn't -- and, obviously, you know, it wasn't intent. It was just the mechanics of getting everything vetted, analyzed and up to the desk in time for the market open and we're missing the cutoff."); 169:23-170:13 ("Q: . . . But is it fair to say that the overall picture on the number of trades that you're claiming, that it was actually a fairly small number? A: Yeah. . . . We made -- we made an effort to

Thus, to the extent that the December 2009 Audit reflected issues closing out fails to deliver on the *customer* side of the business, the record evidence and the Division's own witnesses agree that it was in no respect a "red flag" regarding the buy in procedures of Penson's Stock Loan department.

And in any event, Yancey *did* make a "meaningful inquiry" regarding the December 2009 Audit.¹³⁹ At the January quarterly 3012 meeting, Yancey asked both Delaney and Alaniz whether they needed to get Johnson involved.¹⁴⁰ Yancey was told no:

Q: And what was the response?

A: Mr. Yancey's response was that we should bring in Michael Johnson to the conversation.

...

Q: What did you say?

A: I had told him that I didn't believe that was necessary. All indications from the security lending department and the buy-ins department was that they were cooperative in remediating those issues.¹⁴¹

Yancey was assured that the issues identified in the December 2009 Audit were being remediated.¹⁴² Yancey was entitled to rely on these representations.¹⁴³ A CEO cannot operate

comply with 204. The results of the audit showed we weren't making buy-ins, my group.") (Prop. FOF 74); Ex. 829 at 20-21 (Paz Report).

¹³⁹ See Alaniz Test. at 762:20-763:7 (testifying that Yancey inquired as to whether Johnson should be present to discuss the December 2009 Rule 204 audit); Delaney Test. at 613:13-19; 1354:4-12 (same); Yancey Test. at 1878:6 – 1879:15 (testifying he inquired whether Johnson should be present for additional guidance) (Prop. FOF 45).

¹⁴⁰ Delaney Test. at 613:13-19 ("Mr. Yancey's first reaction was, do I need to get Mike Johnson down here, I believe it was Eric [Alaniz] that said, this is a buy-ins issue, and we. . . we're dealing with the buy-ins department on it."); 1354:4-12 ("A: I recall that he specifically asked if we needed Mike Johnson to attend the meeting. Q: And what was Mr. Yancey told? A: Mr. Yancey was told that this was a buy-ins problem and that -- and that we had been -- the compliance group was working with the buy-ins department to remediate the issue."); Ex. 224 at 329:16-330:2 ("And Mr. Alaniz and myself were . . . briefing him on the specific findings. He, at that point, had made mention of the fact that well, this was something we need to get Mike Johnson in the office for. . . . We, at that point in time, had explained that we didn't think at this point that there was a stock loan issue, that this was really appearing to be a buy-in issue. And we were working with buy-in folks, which don't report in to Mike Johnson but that -- and that we would continue to test this issue going forward.") (Prop. FOF 45).

¹⁴¹ Alaniz Test. at 762:23-763:7.

¹⁴² See Stip. FOF 64, 77; see also Exs. 134, 669 (email from Alaniz to Yancey stating SEC Rule 204 is now the focus of "prompt remediation."); Alaniz Test. at 845:4-13 ("Q: . . . you told Mr. Yancey that you were receiving cooperation from departments for remediation; is that correct? A: Yes. . . Q: Did Mr. Yancey appear to be reassured by that fact? A: I would say yes."); Delaney Test. at 1354:6-12 ("Q: And what was Mr. Yancey told? A: Mr. Yancey was told that this was a buy-ins problem and that -- and that we had been -- the compliance group was working with the buy-ins department to remediate the issue."); Yancey Test. at 1879:7-15 ("Q: What specifically did

effectively if he must continually second-guess the information communicated to him by his direct reports.¹⁴⁴ Any standard to the contrary would contravene the long-accepted concept of delegation and would set a precedent of diligence that would paralyze CEOs.¹⁴⁵ The Division not only failed to carry its burden to prove the December 2009 Audit was a red flag, but the trial record proved Yancey's careful and diligent responses to the audit met the reasonableness standard.

Lastly, it is undisputed that Penson promptly and extensively remediated the issues identified in the December 2009 Audit.¹⁴⁶ Alaniz and Delaney communicated the December 2009 Audit results and the remediation plan to Yancey at a January 28, 2010 quarterly 3012 meeting.¹⁴⁷ Yancey was repeatedly assured that the issues were being remediated.¹⁴⁸ Alaniz

they tell you about buy-ins? A: . . . [T]hat prompt remediation was underway, that they had the full cooperation of the staff . . . and that further testing would begin.") (Prop. FOF 64).

¹⁴³ Ex. 828 at 15-16 (Poppalardo Report); Ex. 829 at 21-22 (Paz Report).

¹⁴⁴ Ex. 828 at 16 (Poppalardo Report).

¹⁴⁵ Ex. 828 at 4, 16 (Poppalardo Report).

¹⁴⁶ Stip. FOF 17, 64, 77; *see also* Alaniz Test. at 859:6-7 ("Q: And did that June test show improvement? A: Yes, it did."); 860:24-861:10 ("Q: I think you testified. . . you did a sort of spot check later with Summer [Poldrack]? A: Correct. Q: And she told you they were getting 100 percent compliance? A: Correct. . . I did a random search on their internal site to review everything that had been bought in for certain days throughout a certain week, and everything was in line with what she had told me."); Gover Test. at 172:11-17 ("Q: . . . the issues that were identified . . . were actually re-tested again in June of 2010; am I correct? A: I believe that's correct. Q: And the results showed significant improvement? A: That's correct."); *see also* Delaney Test. at 1197:4-7.

¹⁴⁷ *See* Exs. 134, 669 (email from Alaniz to Yancey stating SEC Rule 204 is now the focus of "prompt remediation"); Alaniz Test. at 845:4-13; Delaney Test. at 1354:6-12; Yancey Test. at 1879:7-15 (Prop. FOF 64).

¹⁴⁸ *See* Stip. FOF 77; *see also* Exs. 134, 669 (January 28, 2010 email stating SEC Rule 204 is now the focus of "prompt remediation."); Alaniz Test. at 845:4-13 ("Q: . . . In that January meeting . . . you told Mr. Yancey that you were receiving cooperation from departments for remediation; is that correct? A: Yes. . . Q: Did Mr. Yancey appear to be reassured by that fact? A: I would say yes."); Delaney Test. at 1354:4-12 ("Q: And what was Mr. Yancey told? A: Mr. Yancey was told that this was a buy-ins problem and that -- and that we had been -- the compliance group was working with the buy-ins department to remediate the issue."); Yancey Test. at 1879:7-15 ("Q: What specifically did they tell you about buy-ins? A: . . . [T]hat prompt remediation was underway, that they had the full cooperation of the staff . . . and that further testing would begin.") (Prop. FOF 64); Alaniz Test. at 794:20-795:10 (discussing March 2010 meeting, "A: . . . So this year, we brought in individuals so in the event that he had questions, any concerns, he could address it to them directly. Q: And I take it there were some concerns about this 204 testing? A: Yes. Q: And did you feel like they were addressed? A: From the discussions that John Kenny had with Brian, they had -- they had discussed remediation issues or remediation communication items to conform with the rule and I had no issue with that."); 837:8-18 ("Q: Was Mr. Yancey engaged during the course of those meetings? A: Yes. Q: He was attentive? A: Yes. . . . Q: Did he ask some questions? A: Yes. Q: Sometimes detailed questions? A: Sometimes questions we couldn't answer."); 851:20-852:16 ("A: The discussion of 204 was more with the issues that were found and also of the remediation that the -- the subject matter experts were

conducted follow-up testing of the Buy Ins department's procedures in June 2010, the results of which showed significant improvement.¹⁴⁹ And through spot-checks Alaniz confirmed that Penson ultimately achieved 100% compliance.¹⁵⁰

In sum, the December 2009 Audit could not have been a red flag to Yancey, nor any reasonable CEO, regarding Rule 204(a) violations of long sale of loaned securities.¹⁵¹

b. Johnson's absence from the March 31, 2010 3012 meeting was not a red flag.

As the trial record demonstrated, Johnson's absence from the March 31, 2010 3012 meeting was not a "red flag"—it was a non-issue. Indeed, at trial the Division did not ask Johnson a single question about this purported "red flag."¹⁵² Five points demonstrate this.

First, Alaniz—not Yancey—selected the meeting participants and sent the e-mail invitation.¹⁵³ Thus, any suggestion that Yancey instructed Johnson to attend the meeting, and he refused, is incorrect.

Second, Yancey received a separate invitation and had no reason to know that Johnson was even invited.¹⁵⁴

Third, having been assured by his CCO and others in January that Johnson's involvement

implementing. . . Q: Great. And you previously testified that, in fact, Mr. Gover and Mr. Kenny engaged in a 15-minute or so discussion of the remediation efforts; is that right? A: Yes.") (Prop. FOF 80).

¹⁴⁹ See Exs. 85, 610; Alaniz Test. at 859:6-7 ("Q: And did that June test show improvement? A: Yes, it did."); 860:3-9 ("Q: So there was an improvement in the number of fails; is that correct, or percentage of fails? A: Yes . . . And pretty significant? . . . A: Yes."); see also Gover Test. at 172:11-17 (Prop. FOF 5).

¹⁵⁰ Alaniz Test. at 860:24 – 861:10 ("Q: I think you testified. . . you did a sort of spot check later with Summer [Poldrack]? A: Correct. Q: And she told you they were getting 100 percent compliance? A: Correct. . . I did a random search on their internal site to review everything that had been bought in for certain days throughout a certain week, and everything was in line with what she had told me.") (Prop. FOF 5).

¹⁵¹ See Ex. 828 at 15-16 (Poppalardo Report); Ex. 829 at 19-22 (Paz Report).

¹⁵² Compare Johnson Test. at 513-568 (Prop. FOF. 76) with OIP at ¶ 75.

¹⁵³ Stip. FOF 96; See Exs. 674, 99 (calendar invitation sent to Johnson and several other meeting participants, excluding Yancey); see also Yancey Test. at 1882:8-1882:11 ("Q: Okay. Well, now, you said it wasn't your invitation. But did you give direction about who should be invited to attend? A: No, ma'am.") (Prop. FOF 31).

¹⁵⁴ See Ex. 633 (March 31, 2010 meeting invitation circulated separately and only to Yancey and Delaney); Alaniz Test. at 851:2-4 ("Q: So [Yancey's] invitation didn't necessarily show who else had been invited to the meeting; is that right?" A: Correct.") (Prop. FOF 32).

was not needed, Yancey had no reason to think that Johnson was necessary to the March 31, 2010 meeting.¹⁵⁵

Q: And what was the response?

A: Mr. Yancey's response was that we should bring in Michael Johnson to the conversation.

....

Q: What did you say?

A: I had told him that I didn't believe that was necessary. All indications from the security lending department and the buy-ins department was that they were cooperative in remediating those issues.¹⁵⁶

...

Q: And what was Mr. Yancey told?

A: Mr. Yancey was told that this was a buy-ins problem and that -- and that we had been -- the compliance group was working with the buy-ins department to remediate the issue

....

Q: Do you think it reasonable for Mr. Yancey to rely on Mr. Alaniz's statement, the gentleman who had actually done the test?

A: Yes.

Q: Now, did that mean to you that this was not a Mike Johnson issue, that statement from Mr. Alaniz?

A: That's what it meant to me, yes.

....

Q: That's what Mr. Yancey asked about and that's what Mr. Alaniz told you, correct?

A: Correct.¹⁵⁷

Fourth, Yancey would not have expected Johnson to attend the meeting as Johnson had previously informed Penson's executives that it was difficult for him to attend meetings during trading hours.¹⁵⁸

Fifth, Johnson himself rejected the Division's allegation that he "refused to attend" the March meeting.¹⁵⁹ Both Johnson and Delaney testified that other Stock Loan members attended

¹⁵⁵ See Stip. FOF 64, 77; see also Exs. 134, 669 (Prop. FOF 45).

¹⁵⁶ Alaniz Test. at 762:23-763:7.

¹⁵⁷ Delaney Test. at 1354:6-1355:7

¹⁵⁸ Stip. FOF 97 (Johnson Test. at 539:3-6) ("Q: Did you, in fact, tell Mr. Yancey early on that it was difficult for you to attend meetings that occurred during the hours that the securities markets were open? A: I think I told all executives that.").

¹⁵⁹ Johnson Test. at 538:25-539:2 ("Q: Did you ever refuse to attend a March 31, 2010 CEO certification meeting with Mr. Yancey? A: I don't think so.") (Prop. FOF 44).

in Johnson's stead, which is precisely what Alaniz requested in the invitation¹⁶⁰

c. The Summary Report attached to the March 31, 2010 CEO certification was not a red flag.

The absence of an explicit reference to the December 2009 Audit results in the March 31, 2010 Summary Report was not a "red flag" that should have alerted Yancey to intentional Rule 204(a) violations within the Stock Loan department.

Eric Alaniz drafted the 3012 Summary Report, which was appended to Yancey's Rule 3130 CEO Certification.¹⁶¹ Delaney and other members of Penson's Compliance department then reviewed and revised Alaniz's draft as they deemed necessary.¹⁶² As CCO, it was Delaney's responsibility to determine whether an issue rose to the level of a "key compliance issue," such that, pursuant to Penson's WSPs,¹⁶³ it would be included in the Summary Report.¹⁶⁴ This determination was necessarily based on judgment and experience with regard to materiality and risk,¹⁶⁵ and Delaney was in the best position to make this decision.¹⁶⁶

¹⁶⁰ See Ex. 674 (stating, "If for some reason you can't attend please have a representative show up in place of you to discuss the 3012 Test conducted in your respective areas."); Johnson Test. at 539:20-22 ("Q: Okay. Was it your understanding that someone from your team attended or may have attended the meeting? A: Yes."); Ex. 224 at 351:13 ("I recall either Rudy or Brian being there.") (Prop. FOF 24).

¹⁶¹ Alaniz Test. at 856:22-24 ("Q: . . . You prepared the initial draft of that, right? A: Of that, yes.") (Prop. FOF 33).

¹⁶² Delaney Test. at 1361:10-24 ("Q: . . . One of your jobs as the Chief Compliance Office is to prepare the annual 3012 report; is it not? A: It is. Q: And you do that with the assistance of the – your fellow compliance colleagues? A: That's correct. Q: You and your department made the determination of what to include in that Summary Report, fair? A: Fair."); 679:10-17 ("Q: . . . [Y]ou said that you're responsible for the 3012 Summary Reports; is that right? A: I – I am ultimately responsible for the reports, yes."); Alaniz Test. at 719:9-12 ("Q: Who decided what was put into that report? A: Initially, I would create the template. I would put in a few items that we would discuss. And from there, I would send it to Tom Delaney to complete.") (Prop. FOF 78).

¹⁶³ Stip. FOF 45 (quoting language from Penson's WSP); see also Ex. 746 at 87 (WSPs).

¹⁶⁴ Delaney Test. at 673:18-20 ("Q: Okay. And at Penson, you were responsible for contents of the 3012 report; isn't that right? A: I was."); Alaniz Test. at 719:13-15 ("Q: Okay. So who was it that decided whether items would be listed as significant compliance problems? A: I would ask Tom Delaney on that.") (Prop. FOF 79); see also Yancey Test. at 1886:22-1887:4; Ex. 828 at 18 (Poppalardo Report).

¹⁶⁵ See Ex. 828 at 18 (Poppalardo Report); Ex. 829 at 23 (Paz Report).

¹⁶⁶ Delaney Test. at 1361:22-1363:1 ("Q: You and your department made the determination of what to include in that Summary Report, fair? A: Fair. . . . Q: Do you believe that Mr. Yancey, as the Chief Executive Officer of Penson, was entitled to rely on the judgment of you and all of your subordinates in the Compliance department as to what information should be included in the Summary Report? A: Yes. Q: Do you know of any reason whatsoever that Mr. Yancey should have overruled the judgment of the Compliance department about what should go in that report? A: No."); see also Yancey Test. at 1886:22-1887:4.

Neither Delaney nor Alaniz believed that the December 2009 Audit results rose to the level of a “key compliance issue.” Alaniz testified that while he certainly could have recommended that the results be included in the Summary Report, he didn’t think it was necessary.¹⁶⁷ Delaney likewise agreed that the December 2009 Audit results did not warrant inclusion in the report because of the substantial remediation efforts that were well underway.¹⁶⁸ Delaney’s and Alaniz’s testimony is unremarkable. The Summary Report was just that—a *summary*. By definition, it did not include all issues or the results from every 3012 audit that the Firm performed throughout the year. Indeed, Alaniz and Delaney both confirmed that *none* of the approximately twenty Rule 3012 tests conducted for that year were explicitly referenced in the summary report.¹⁶⁹ Given the number of regulatory inquiries that Penson received, by virtue of the volume of the transactions that it was clearing, it is both logical and understandable that the technical violations identified in the December 2009 Audit would not warrant inclusion on a list of “key compliance issues.”¹⁷⁰

¹⁶⁷ Alaniz Test. at 857:22-858:23 (“Q: But you got direction on what to include from Mr. Delaney; is that right? A: Correct. . . . Q: Have you had discussions with him about other issues, about what to include in a report or what not to include in a report . . . about what’s important and what’s not important? A: Yes. Q: And he was receptive to that? A: Yes. Q: So if you had thought it was an important issue and should have been included, you had the ability to tell him to include it? A: Yes.”) (Prop. FOF 77); *see also* Alaniz Test. at 858:7-23 (“Q: If you had wanted that to be included, would you have suggested that to Mr. Delaney? A: I believe we definitely would have had a discussion about it. . . . Q: So if you had thought it was an important issue and should have been included, you had the ability to tell him to include it? A: Yes.”) (Prop. FOF 25); *see also* Alaniz Test. at 826:13-21.

¹⁶⁸ Delaney Test. at 1360:25-1361:10 (“Q: And the December audit. . . was not explicitly listed as an item in that Summary Report; do you agree with that? A: I do. Q: Why was it not specifically identified? A: The testing results from Eric that had come, that had been reported out, had already been substantially starting to be remediated at that point, and it was inclusive in the material that was there with the report.”) (Prop. FOF 25, 40); *see also* Poppalardo Test. at 1959:24-1960:7 (“A: But we don’t see. . . every exception that’s been identified in an examination report or an internal testing, because there’s just too many. . . There’s got to be some judgment, and you have to—and it’s really the Chief Compliance Officer who determines what it material enough to—to be in the report.”); *see also* Ex. 828 at 18 (Poppalardo Report) (“I do not believe there was an omission in the 3012 Summary Report regarding the results of the December 2009 Rule 3012 audit. . . . The 3012 process would quickly become unwieldy if firms included all regulatory and internal testing findings in their 3012 reports.”) (Prop. FOF 40).

¹⁶⁹ Alaniz Test. at 857:19-21 (“Q: And you said earlier none of your 3012 testing for the year was included in that, right? A: Correct.”); Delaney Test. at 1303:8-18 (“Q: How many different tests do you recall having been run during that cycle, if you know? A: I don’t know, but it was a lot. Q: . . . Were the specific results of any of those tests disclosed in this Summary Report? A: No. Q: Not any of the tests? A: Not any of the tests.”) (Prop. FOF 87).

¹⁷⁰ Ex. 829 at 23 (Paz Report).

As CEO, Yancey was entitled to rely on Delaney's and Alaniz's determination that the December 2009 Audit did not rise to the level of a "key compliance issue."¹⁷¹ As demonstrated above, the December 2009 Audit revealed an extraordinarily small subset of transactions that the Buy Ins department had failed to close out by market open.¹⁷² Yancey had been assured that the issues were being remediated, and significant remediation efforts were, in fact, underway.¹⁷³ Yancey knew that the relevant business unit supervisors had agreed to an action plan, which included follow-up testing.¹⁷⁴ As Ms. Poppalardo testified, this is precisely "what you want to see as a CEO."¹⁷⁵ Indeed, Delaney himself acknowledged that there was no reason that Yancey should have overruled the judgment of the Compliance department regarding the contents of the

¹⁷¹ See Ex. 829 at 23 (Paz Report); Ex. 828 at 18 (Poppalardo Report); Poppalardo Test. at 1998:3-12 ("Q: Can you tell me a little about what reliance the CEO can give to the reports that he receives . . . A: If you trust the people under you, I think that most CEOs will rely on – on the face of the report. . . I've not seen any CEOs, you know, that go much beyond just receiving the report. They get comfortable enough with the areas that have been tested and the results as they've been represented to them, and they execute a certification."); Yancey Test. at 1885:14-1886:2 ("Did you ask any questions or have any discussions with people prior to signing it? A: Yes, ma'am. Q: Can you tell me about those, please? A: I ask a lot of questions about a lot of things, but the big question that I always ask is: Does anybody know of any reason that I wouldn't sign this or that Tom wouldn't sign this? Is there anything at all that we should know, that we should do? Is there anything about it we could do before I sign this document? Q: Who did you ask that of? A: I certainly asked it of Tom Delaney, Eric Alaniz. . . "); 1887:22-1888:13 ("Q: Did you have any reason to disagree with Mr. Delaney's inclusion or exclusion of material on his Summary Report? A: No ma'am. . . Q: Did you believe then or now that Mr. Delaney concealed anything in completing this Summary Report? A: No, I don't. . . No doubt that he was completely forthright with me.").

¹⁷² Gover Test. at 165:24-170:4 ("Q: How many trades do you think Penson cleared on a daily basis? A: I had seen them between three and 5 million. . . Q: And – and the overwhelming number of those trades settled without issue: is that fair? A: Absolutely. . . We did not have to send very many orders to the execution desk to be bought in . . . Q: Right. They can say whatever they want and kind of point to that last final piece of the buy-ins . . . But is it fair to say that the overall picture on the number of trades that you're claiming, that it was actually a fairly small number? A: Yeah."); Yancey Test. at 903:20-25 (Prop. FOF 74).

¹⁷³ See Stip. FOF 77; see also Alaniz Test. at 795:7-21; 851:20-852:16.

¹⁷⁴ Stip. FOF 77; see also Yancey Test. at 1879:7-15 ("Q: What specifically did they tell you about buy-ins? A: . . . [T]hat prompt remediation was underway, that they had the full cooperation of the staff . . . and that further testing would begin."); see also Alaniz Test. at 845:4-19 ("Q: . . . you told Mr. Yancey that you were receiving cooperation from departments for remediation; is that correct? A: Yes. Q: And indeed, that was your belief, right? A: Yes. Q: Did Mr. Yancey appear to be reassured by that fact? A: I would say yes. Q: He was satisfied? A: Yes. Initially he was concerned. And after we discussed that the cooperation was forthcoming from the departments, it appeared that he was okay with that."); Delaney Test. at 1354:6-12; Exs. 134, 669 (email stating SEC Rule 204 is now the focus of "prompt remediation") (Prop. FOF 64).

¹⁷⁵ Poppalardo Test. at 1998:17-24 ("I think that's what every CEO wants to see. They want to see that they had a process in place. The process highlighted certain exceptions or activity. The people in the business lines who are responsible have agreed to do whatever it is to remediate that, and, you know, that the remediation is going to occur by X date. I think that's exactly what you want to see as a CEO.").

report.¹⁷⁶

Moreover, the trial record confirms that the December 2009 Audit results were not concealed from regulators. Indeed, Alaniz testified that he maintained and made available to FINRA regulators all of the 3012 testing materials, including the testing materials from the December 2009 Audit.¹⁷⁷

d. Penson's November 24, 2010 OCIE response was not a red flag.

Lastly, the Division alleges that Penson's November 24, 2010 response to an OCIE exam contained misrepresentations that should have alerted Yancey to intentional Rule 204(a) violations with respect to long sales of loaned securities. Specifically, the Division alleges that Penson's statements that its Rule 204(a) processes were reasonable, effective, and performed as designed were false in light of the December 2009 Audit results.¹⁷⁸ But the testimony of the Division's *first witness* exposed the absurdity of this argument.

First, Brian Gover—the Division's first witness and the author of the statements—confirmed at trial that the statements were accurate and that, to this day, he has no reason to believe that they were not accurate.¹⁷⁹ Tellingly, the Division did not ask Gover whether he, as

¹⁷⁶ Delaney Test. at 1362:22-1363:1 (“Q: Do you know of any reason whatsoever that Mr. Yancey should have overruled the judgment of the Compliance department about what should go in that report? A: No.”) (Prop. FOF 39); *see also* Yancey Test. at 1887:22-1888:13 (“Q: Did you have any reason to disagree with Mr. Delaney’s inclusion or exclusion of material on his Summary Report? A: No, ma’am.”).

¹⁷⁷ Alaniz Test. at 804:12-805:3 (discussing 3012 test results, “A: No, I would put all my documentation in folders and keep them there. Q: And why -- why is it that you’d keep them there? A: Well, they were able to be reviewed by the regulators, FINRA specifically. Q: Okay. So FINRA can come in and ask for it and you -- A: Exactly. Q: Did that ever happen when you were at Penson? A: Yes.”) (Prop. FOF 26); *see also* Ex. 135 (3012 testing documentation was “available in the Compliance Department”); Delaney Test. at 1304:10-24 (“Q: . . . Would that [documentation of testing] include . . . Exhibit 70? . . . A: Absolutely. . . Q: How large would that have been for all the tests? A: These are binders. . . kept in bankers [boxes] . . . when we would carry them in to hand them over to the regulators when they would ask to see them, we would literally carry in bankers boxes. . . with the testing results. So there’s just no practical way to attach those results.”); 1305:4-7.

¹⁷⁸ OIP at 16, ¶ 82; *see also* Stip. FOF 30 (Ex. 86) (Gover’s November 8, 2010 draft contained the language: “Penson feels that the processes and procedures employed to close out positions that were in violation of Rule 204T were effective and performed as designed.”).

¹⁷⁹ Stip. FOF 61 (Gover Test. at 147:21-148:4) (“Q: Okay. When you -- when you wrote that, you would have understood that was going to FINRA, right? A: Yes. Q: And when you wrote that, did you believe it was accurate? A: Yes. Q: And as you sit here today, is there any reason to think that it’s not accurate? A: No.”).

the author of the statements, thought that they were true and correct. Indeed, the Division did not ask Gover a single question about the statements.¹⁸⁰

Second, multiple other witnesses confirmed that the statements at issue were truthful statements. Holly Hasty—Penson’s Deputy CCO—agreed that the statements were accurate and true.¹⁸¹ Delaney likewise agreed that the statements were true and correct.¹⁸² As did Yancey.¹⁸³

Third, by the time of the OCIE response the Rule 204(a) issues identified in the December 2009 Audit had been remediated.¹⁸⁴ Those remediation efforts had been repeatedly communicated to Yancey and ultimately confirmed by Alaniz’s follow-up testing conducted in June 2010 and his spot-check.¹⁸⁵ Thus, Penson’s Rule 204 procedures were, in fact, “reasonable” and “effective and performed as designed.”

Lastly, not only was the language at issue drafted by Gover, the subject-matter expert, but it was also reviewed by multiple members of the Operations and Compliance departments,

¹⁸⁰ The Division asked Gover no questions regarding the OCIE response. *See* Gover Test. at 74-198. (Prop. FOF 81).

¹⁸¹ Hasty Test. at 1738:25-1739:10 (“Q: Okay. And as you sit here today, Ms. Hasty, do you believe that Mr. Gover’s statement that ‘Penson’s processes and procedures were effective and performed as designed,’ do you believe that was truthful and accurate? A: Yes. Q: Do you have any reason to believe that Mr. Gover’s statement was inaccurate? A: No. Q: Misleading? A: No.”) (Prop. FOF 19).

¹⁸² Delaney Test. at 1365:13-21 (“Q: The sentence that reads, ‘Penson believes that the reasonable processes employed to close-out positions that were allegedly in violation of Rule 204T were effective and performed as designed,’ do you see that? . . . Do you feel like that sentence was false? A: No. Q: Do you feel like that sentence was misleading? A: No. Q: Do you feel like that sentence was wrong, confusing or unclear? A: No.”) (Prop. FOF 19).

¹⁸³ Yancey Test. at 1897:5-13 (“Q: . . . It says: Penson believes that the reasonable processes employed to close out positions that were allegedly in violation of Rule 204T were effective and performed as designed. Do you see that? A: I see it. Q: And did you believe that to be correct at the time? A: Yes, ma’am.”) (Prop. FOF 19); *see also* Ex. 829 at 23-24 (Paz Report); Ex. 828 at 18-19 (Poppalardo Report).

¹⁸⁴ Stip. FOF 17, 64, 77.

¹⁸⁵ *See* Exs. 85, Ex. 610; Alaniz Test. at 859:6-7 (“Q: And did that June test show improvement? A: Yes, it did.”); 860:3-9 (“Q: So there was an improvement in the number of fails; is that correct, or percentage of fails? A: Yes . . . And pretty significant? . . . A: Yes.”); Gover Test. at 172:11-17 (“Q: And then the – the issues that were identified in the December audit were actually re-tested again in June of 2010; am I correct? A: I believe that’s correct. Q: And the results showed significant improvement? A: That’s correct.”); Alaniz Test. at 860:24-861:10 (“Q: . . . you did a sort of spot check later with Summer [Poldrack]? A: Correct. Q: And she told you they were getting 100 percent compliance? A: Correct. . . . I did a random search on their internal site to review everything that had been bought in for certain days throughout a certain week, and everything was in line with what she had told me.”) (Prop. FOF 5).

including Hasty and Delaney, and often outside counsel.¹⁸⁶ Indeed, there were at least three levels of review by experts below Yancey.¹⁸⁷ Yancey was entitled to rely on the conclusions reached by these qualified individuals, particularly given that Yancey had confirmed that the issues identified in the December 2009 Audit were the focus of prompt remediation efforts.¹⁸⁸

In sum, the trial record overwhelmingly demonstrates that Yancey reasonably discharged his duties and obligations as both CEO and Delaney's supervisor. Yancey reasonably supervised Delaney and properly delegated supervisory responsibility.¹⁸⁹ Yancey and Delaney had a robust routine that included meeting at least twice a week.¹⁹⁰

The trial evidence confirmed that the Division's "red flag" allegations greatly overstepped the factual bounds in this case. The Division failed to meet its burden to prove that any of the four alleged "red flags" were, in fact, a "red flag." For issues that rose to Yancey's attention, he responded reasonably and decisively.¹⁹¹ To find a failure to supervise on these facts

¹⁸⁶ See Ex. 86 (Gover circulating the draft response); Ex. 208 (Delaney's comments to draft response); Delaney Test. at 1279:20-1280:1 ("Q: And who would you send it to? A: So it would go out, like I said, to the various subject matter experts who had the expertise on the particular issue. So we wouldn't send the letter out in whole, necessarily, we might just send a cut-and-paste of a particular section. And that would go to that subject matter expert for—for their comment and response."); Stip. FOF 101 (Hasty Test. at 1734:24 – 1736:16) ("A: . . . Once that was completed and we had a complete draft, the draft would then be circulated back to that initial group that was part of the entire drafting process for review, which also included, again, reviews by legal, sometimes -- most -- sometimes outside counsel, too, depending on subject matter. And once we came to a final consensus that the draft was ready to go, then it would be sent.") (Prop. FOF 83).

¹⁸⁷ See e.g., Exs. 86, 208; Delaney Test. at 1368:8-19 ("Q: . . . So three levels of review before Mr. Yancey sees the letter; fair? A: That's fair.") (Prop. FOF 37).

¹⁸⁸ See Stip. FOF 64, 77; Ex. 134 (email stating SEC Rule 204 is now the focus of "prompt remediation"); see also Stip. FOF 61; Ex. 829 at 23-24 (Paz Report); Ex. 828 at 18-19 (Poppalardo Report); Hasty Test. at 1738:25-1739:10 ("Q: Okay. And as you sit here today, Ms. Hasty, do you believe that Mr. Gover's statement that 'Penson's processes and procedures were effective and performed as designed,' do you believe that was truthful and accurate? A: Yes. Q: Do you have any reason to believe that Mr. Gover's statement was inaccurate? A: No. Q: Misleading? A: No."); Delaney Test. at 1365:13-21; Yancey Test. at 1896:4-1897:23 (Prop. FOF 19).

¹⁸⁹ See Ex. 828 at 13- 15 (Poppalardo Report).

¹⁹⁰ Delaney Test. at 1339:1-19 ("Q: Did he meet with you regularly? . . . A: As part of a rigor, at least a couple times a week, but in many cases more than that . . . Q: Did Mr. Yancey have a routine group meeting of all his direct reports? A: He did."); Yancey Test. at 1840:9-25 ("Q: What was your approach in terms of supervising the people who were your direct reports . . . A: I set up a one-on-one with them, and then I held a regular Tuesday morning at 9:00 a.m. staff meeting for my direct reports every week.") (Prop. FOF 23).

¹⁹¹ See, e.g., Alaniz Test. at 837:8-18 ("Q: Was Mr. Yancey engaged during the course of those [3012] meetings? A: Yes. Q: Was he attentive? A: Yes. Q: And he showed interest in what you were doing? A: Yes. Q: Did he ask some questions? A: Yes."); Delaney Test. at 1354:4-12.

would suggest that neither Yancey, nor any CEO, can rely on business line supervisors and properly qualified licensed individuals and experts, including supervisory delegates, to perform their duties.¹⁹² The Division seeks to advance a standard of omniscience for CEOs that is wholly unreasonable and contravenes the purpose and design of Rule 204 and the concept of a “reasonably designed” supervisory system.¹⁹³

C. The trial record demonstrates that Penson had established procedures, and a system for applying such procedures, to prevent and detect violations and that Yancey reasonably satisfied his duties and obligations without reasonable cause to believe that the procedures and system were not being followed.

The Division’s supervisory claims against Yancey fail for another, independent reason. Penson had established procedures, and a system for applying such procedures, to prevent and detect violations, and Yancey reasonably satisfied his duties and obligations without reasonable cause to believe that the procedures and system were not being followed.

1. Penson had procedures and systems reasonably designed to prevent and detect violations.

A “reasonably designed” standard “recognizes that a supervisory system cannot guarantee firm-wide compliance with all laws and regulations,” only that the system “be a product of sound thinking and within the bounds of common sense, taking into consideration the factors that are unique to a member’s business.”¹⁹⁴ There is no “perfect” supervisory system, nor is that the standard.¹⁹⁵ Just because a system could have been “more reasonably designed” does not mean that it is unreasonable as designed.¹⁹⁶

During the relevant period, Penson had systems and procedures reasonably designed to

¹⁹² See Ex. 828 at 4, 16 (Poppalardo Report).

¹⁹³ See Ex. 829 at 4, 17-19, 24-25 (Paz Report); Ex. 828 at 4, 16 (Poppalardo Report).

¹⁹⁴ NASD Notice to Members 99-45 (June 1999) (NASD Provides Guidance on Supervisory Responsibilities) (Prop. COL 36).

¹⁹⁵ See *IFG Network Sec.*, 2006 WL 1976001 (the Commission rejected the Division’s arguments that the broker-dealer President failed to exercise reasonable supervision, in part because a different system would have been “more reasonably designed” to prevent the violations) (Prop. COL 35).

¹⁹⁶ See *id.*

achieve compliance with applicable securities laws, rules, and regulations.¹⁹⁷ Business units were supervised by appropriately qualified individuals, reasonable written policies and procedures were in place, and the firm was subject to regular testing to ensure that supervisory procedures were being carried out effectively.¹⁹⁸

a. Business units were supervised by qualified individuals.

Penson's supervisory system assigned qualified experts over each line of business and included written policies and procedures designed to prevent and detect violations of the securities laws.¹⁹⁹ Delaney and Johnson were both qualified, experienced, and provided no basis for Yancey to doubt their competence or compliance with the securities laws.²⁰⁰ Furthermore, Yancey had a long-established relationship with and high level of trust in Pendergraft, who was not only qualified, but confirmed by many witnesses as the most-equipped person in the firm to supervise Johnson.²⁰¹ Yancey had frequent, substantive discussions with those to whom he directly delegated supervisory responsibility.²⁰² His direct reports testified to his high standards, accessibility, and engagement.²⁰³ Pendergraft also confirmed that he and Yancey met regularly

¹⁹⁷ See Ex. 828 at 7-13 (Poppalardo Report).

¹⁹⁸ See Ex. 828 at 7-13 (Poppalardo Report).

¹⁹⁹ See Ex. 828 at 7-8 (Poppalardo Report).

²⁰⁰ See Ex. 241 (Delaney's CRD) (Prop. FOF 88); Pendergraft Test. at 1583:2-6 ("A: Well, he was certainly the best qualified candidate that we interviewed. I mean, I recall Mr. Delaney being our first choice for the job. So he was certainly -- I think we felt like he was qualified and he was the best candidate that we had seen.") (Prop. FOF 60); see also Stip. FOF 55; Ex. 242 (Johnson's CRD) (Prop. FOF 89); Yancey Test. at 1862:5-22 ("He's very well-equipped. He's got great counterparty relationships. He's real systems oriented. He came from -- he had a rich background. . . . Mike was very respectful to me. . . and we never had any bad exchanges.") (Prop. FOF 90).

²⁰¹ See Stip. FOF 82; see, e.g., Delaney Test. at 1343:22-1344:9 ("Q:..between Mr. Yancey and Mr. Pendergraft, in your opinion, was one more qualified than the other to supervise the Stock Loan function? A: From a broker-dealer's standpoint, I think Mr. Pendergraft was more qualified."); Poppalardo Test. at 1962:16-24 ("Q:..do you have an opinion on which is the most appropriate license for supervising securities lending? A: . . . In my opinion, I think the Series 27 is the more appropriate license. . . .") (Prop. FOF 91).

²⁰² Delaney Test. at 1339:1-19; Yancey Test. at 1840:9-14; McCain Test. at 2178:14-25 (Prop. FOF 23).

²⁰³ See, e.g., Delaney Test. at 1339:23-1340:1 ("Q: Was Mr. Yancey an accessible supervisor? A: He was. Q: Was he an engaged supervisor? A: He was."); Hasty Test. at 1701:25-1702:8 ("A:.. he was always present at different meetings that we would have, and he was always very engaged. . ."); Wetzig Test. at 423:16-424:3; McCain Test. at 2178:5-7; Alaniz Test. at 837:8-18; Gover Test. at 176:18-177:9 (Prop. FOF 30).

to discussion Johnson's performance so that Yancey could follow-up on Stock Loan activities.²⁰⁴

b. Penson's policies and procedures were reasonable.

Penson's WSPs reasonably put registered personnel on notice of regulatory requirements and Firm practices, they clearly vested supervisory responsibility in specific individuals, and they addressed an array of subjects consistent with what the SEC and FINRA would reasonably expect the WSPs to contain.²⁰⁵ The WSPs, and specifically Stock Loan's WSPs,²⁰⁶ were subject to regular review and update through a collaborative process between the Compliance department and operational subject-matter experts.²⁰⁷ Penson's Reg SHO and Rule 204 policies and procedures addressed all elements of the rule, set out procedures to be followed, and identified individuals and supervisors responsible for compliance.²⁰⁸

The trial record established that in addition to the WSPs, Penson's business units, including Stock Loan, used additional methods to ensure compliance with various elements of Rule 204, including embedding compliance features in automated systems²⁰⁹ and using checklists, training, and orally-communicated protocols, such as guidance from senior staff and

²⁰⁴ Pendergraft Test. at 1537:5-10 ("Q: Fair enough. Mr. Yancey routinely checked in with me regarding those activities, and I believe acted reasonably in ensuring that Mr. Johnson and the Stock Lending group were properly conducting business in accordance with the securities laws. A: I believe that."); Yancey Test. at 1859:5-11 ("Q: What did you see? What did you observe Mr. Pendergraft doing? A: . . . I saw him talking to Mike Johnson. I talked to Phil about Mike Johnson. I talked to Phil at length . . .") (Prop. FOF 11).

²⁰⁵ See Ex. 828 at 9-10 (Poppalardo Report); see, e.g., FINRA Supervisory Checklist, contained in FINRA Continuing Membership Guide, located at <http://www.finra.org/industry/compliance/registration/memberapplicationprogram/cmguide/p009725> (Prop. COL 37).

²⁰⁶ See Ex. 657 (email from Alaniz to members of Stock Loan asking for review, update, and sign-off on WSPs).

²⁰⁷ Hasty Test. at 1712:19-1713:11 ("Q: And when you were at Penson, did you understand that the WSPs was to be updated? A: Yes, they were updated regularly. Q: And if you can, what -- at a high level, how did that process work? A: Typically, it could happen a couple of different ways. One could be there could be a change or a modification to a rule or a regulation that would require us to make a targeted change to the WSPs. It could also be as a result of an annual review or a regular review of the WSPs, where the WSPs are sent out to the various business owners in all of the different areas that those WSPs that attach to each business unit are sent to the managers of those units for them to review, to let us know if there's anything that needs to be updated or anything that's changed in their day-to-day work that we need to address in those procedures.") (Prop. FOF 53).

²⁰⁸ See, e.g., Ex. 540 at 383-399; Ex. 746 at 325-341; Ex. 828 at 10-12 (Poppalardo Report) (Prop. FOF 92).

²⁰⁹ See Wetzig Test. at 365:6-17 ("A: So Sendero is essentially a front-end software of a Stock Loan system that was built for Penson . . . Sendero was a very accurate system.").

supervisors.²¹⁰

Penson also used well-designed, fulsome, and reasonable processes and protocols to implement a new rule or regulation, such as Reg SHO and Rule 204.²¹¹ The Compliance department issued special compliance memorandums and other guidance,²¹² formed working groups or engaged technology resources to help develop and implement process changes,²¹³ subscribed to comprehensive training packages from FINRA and provided other training,²¹⁴ and held annual compliance meetings.²¹⁵

c. Regular and robust 3012 testing ensured that procedures were effective.

Dedicated staff were responsible for 3012 testing each year, areas tested were risk-based,

²¹⁰ See, e.g., Exs. 519, 582 (Penson maintained procedures for deficit determination and resolution that provide the specific steps in calculating the Firm's segregation requirements, which includes recall of bank and stock loan, issuance of buy-ins, attempts to borrow, etc.); Hasty Test. at 1713:17-1714:16 ("Q: Now, you mentioned, I think you called it maybe a desk book or something. Were there other written materials that Penson's business units relied on? A: Some of the various business units did have desktop procedures or other types of guides that they used to help them with their day-to-day activities. . . . Q: And so how—what is the function of those procedures as compared to the WSPs? A: Typically, those are more user level-type manuals. They're defined to specifically instruct somebody what they should do in a particular situation. They're designed to be step-by-step guides to how you would conduct your work or your business or how you might answer a question that you might have, and not designed necessarily to provide a high-level overview."); Wetzig Test. at 393:16-23 ("Q: What about Stock Loan; did Stock Loan have a set of desk procedures? A: We essentially had a checklist of items that we needed to do every day to get our job done. . . you could refer to them as desk procedures, I would say.") (Prop FOF 93).

²¹¹ See Hasty Test. at 1707:11-1719:24 (Prop. FOF 50).

²¹² See Exs. 302, 729, 125; Hasty Test. at 1719:18 – 1720:5 (Prop. FOF 94).

²¹³ See Hasty Test. at 1715:15 – 1716:4 (describing working groups); 1718:13-23 ("Q: What did Penson do to ensure compliance with Rule 204? A: I know the firm updated its procedures. There was technology efforts to create new reports and new information that was being used. . . ."); 1723:16-1724:14 ("Q: Were you on an IT steering committee? A: I was on an IT steering committee. Q: And what was your role? A: . . . So my role was to provide compliance guidance and also to determine whether something needed to be escalated because it was something that was regulatory and needed to be completed perhaps in front of something that would – might be considered an enhancement. Q: . . . Do you remember whether Rule 204 was something that needed to be escalated? A: I do. I specifically remember Brian Gover requesting some help with the 204 buy-in reports . . . and he had requested that I review it and escalate it through the steering committee to get development resources put on that project more quickly. Q: And did you do that? A: I did.") (Prop. FOF 95).

²¹⁴ See Hasty Test. at 1710:6 – 1712:6 ("A: . . . Penson subscribed to FINRA's webinar series. We took all of the training that was provided by FINRA, and we would make those available to different groups. . . . what we like to refer as the all you can eat program. . . .") (Prop. FOF 34); see also Ex. 384 (list of "key participants" to participate in Reg SHO training); Hasty Test. at 1740:12-14 (Prop. FOF 52).

²¹⁵ See Hasty Test. at 1710:16-21 ("A: . . . We conducted an annual compliance meeting every year that touched on a lot of different just high-level security regulations. Every single business unit was given one or two different targeted training modules that they had to complete.") (Prop. FOF 50).

and there was a system for implementing and following up on necessary remediation.²¹⁶ A significant amount of testing occurred each year and deficiencies identified in 3012 testing and regulatory examinations were tracked and assigned to the appropriate business unit for remediation.²¹⁷ It was the Firm's practice during the relevant time period to conduct several tests each quarter across a variety of different areas that were the focus of new regulatory rules and priorities.²¹⁸ The results of 3012 testing and remediation efforts were discussed between Compliance staff and Yancey, and business unit leaders or subject-matter experts were consulted as necessary.²¹⁹ In fact, in connection with the CEO certification process, Yancey met *more frequently* than the annual basis that Rule 3130 required to discuss issues identified in the Rule 3012 testing process.²²⁰ The trial evidence shows that in these meetings Yancey was thorough, decisive, and engaged.²²¹ In addition to the 3012 testing program, PWI's Internal Audit program also conducted audits of Penson departments and reported those findings to PFSI and PWI

²¹⁶ See Poppalardo Test. at 1995:8-10 ("A: I thought they had a very good – a very robust Series [30]12 testing process. It was better than a lot that we've seen."); Ex. 828 at 12-13 (Poppalardo Report) (Prop. FOF 68).

²¹⁷ See Alaniz Test. at 714:10-12 ("I typically test around 20 items, on average, a year."); 739:13-19 (regarding the testing cycle that ended March 31, 2010 "Q: Okay. How many different items. . . did you test during that testing cycle? A: 20, 21. Typically around the range of 20. . . That's the [annual] average."); Poppalardo Test. at 1995:8-10 ("A: I thought they had a very good – a very robust Series [30]12 testing process. It was better than a lot that we've seen."); Ex. 828 at 12-13 (Poppalardo Report) (Prop. FOF 68).

²¹⁸ See, e.g., Ex. 722 (evidencing that in one year, Penson conducted testing in at least 14 different areas); Alaniz Test. at 714:10-12, 705:6-19 (discussing the annual 3012 testing, "A: . . . I reviewed FINRA sites, SEC sites. I would check in to our regulatory compliance [a]rea. I would ask to see what the regulators were asking about. And then from there, I would gather a list of topics. From that point, I would take it to Tom Delaney. We'd create a list."); Ex. 828 at 12-13 (Poppalardo Report) (Prop. FOF 96).

²¹⁹ See Exs. 669, 507, 633; Alaniz Test. at 794:20-795:25 ("A: . . . The reason we brought these business owners into this meeting. . . after going through all the items, he [Yancey] would have questions that only the business owners could answer."); 845:4-19 (Prop. FOF 64) (Prop. FOF 48) (Prop. FOF 80).

²²⁰ Stip. FOF 90 (Yancey Test. at 882:23-883:11) ("I wanted there to be vibrant testing more than once a year. And so I worked with my CCO to develop a good routine for testing and then meet on a quarterly basis to make sure that we had the opportunity to detect things that might not be going as well as we'd like and have the opportunity to remediate them so that, in the certification, we would be confident about the test and the results.").

²²¹ See Ex. 692 (email from Delaney to Yancey stating: "We continue to appreciate your participation in this process as you set a meaningful tone at the top related to compliance efforts of the firm."); Alaniz Test. at 837:8-18 ("Q: Was Mr. Yancey engaged during the course of those [3012] meetings? A: Yes. Q: Was he attentive? A: Yes."); (Prop. FOF 97); Hasty Test. at 1701:25-1702:8 (Prop. FOF 30).

management.²²²

2. Yancey reasonably discharged his duties and obligations without reasonable cause to believe the procedures and systems were not being complied with.

Yancey relied on the many qualified licensed individuals at Penson to employ good judgment, take decisive action, and escalate unresolved issues to his attention.²²³ Yancey exercised effective supervision over all of his direct reports, including Penson's CCO Tom Delaney, and followed up on the delegation of supervisory responsibilities.²²⁴ Yancey facilitated the free flow of information by meeting with each direct report and his superiors twice a week—as a group and one-on-one.²²⁵ He was an engaged and accessible CEO and had frequent, substantive discussions with all levels of Penson personnel.²²⁶ Yancey prioritized the Compliance department through the allocation of numerous resources over several years.²²⁷ Yancey was a committed, honest, ethical, diligent, and compliance-minded.²²⁸

²²² See, e.g., Ex. 724 (circulation of Buy Ins internal audit report to various PFSI and PWI personnel).

²²³ See Delaney Test. at 1368:20-24 (“Q: Can you think of any reason whatsoever why Mr. Yancey should not have been entitled to rely on the judgment of you, Ms. Hasty as Mr. Gover as to the truth of that statement? A: No.”) (Prop. FOF 38); Ex. 828 at 18 (Poppalardo Report) (“Mr. Yancey, like most CEOs in the industry, relied on the report prepared by his CCO, and I believe his reliance was reasonable . . .”) (Prop. FOF 39).

²²⁴ Delaney Test. at 1339:1-19 (“Q: Did he meet with you regularly? . . . A: As part of a rigor, at least a couple times a week, but in many cases more than that . . . Q: Did Mr. Yancey have a routine group meeting of all his direct reports? A: He did.”); Yancey Test. at 1840:9-25 (“Q: What was your approach in terms of supervising the people who were your direct reports . . . A: I set up a one-on-one with them, and then I held a regular Tuesday morning at 9:00 a.m. staff meeting for my direct reports every week.”); McCain Test. at 2178:14-25 (“A: . . . He held a weekly management meeting that included all of his direct reports”) (Prop. FOF 23); see also Yancey Test. at 948:18 (“So I fully delegated it to him. He accepted that delegation. And then there became a pattern and practice of follow-up routine communication between Phil and I to ensure that -- that his supervision was adequate and -- and appropriate.”); Pendergraft Test. at 1540:10-20 (“A: Yes. Q: I observed him properly and diligently supervising the PFSI business by assigning responsibility as appropriate and following up. A: Yes, sir. Q: In that regard, I believe that Mr. Yancey acted as a reasonable CEO of a broker-dealer. A: Yes, sir, I believe that.”), 1537:5-10 (“Q: Fair enough. Mr. Yancey routinely checked in with me regarding those activities, and I believe acted reasonably in ensuring that Mr. Johnson and the Stock Lending group were properly conducting business in accordance with the securities laws. A: I believe that.”) (Prop. FOF 11).

²²⁵ See *id.*

²²⁶ See, e.g., Delaney Test. at 1339:23-1340:1; Hasty Test. at 1701:25-1702:8 (Prop. FOF 30).

²²⁷ Stip. FOF 72; see also Delaney Test. at 1340:17-1340:24 (“When I started with the Compliance department, it was about a team of five or so, and at our high point we had over 25 compliance associates that were in that department. It was a meaningful -- it was a meaningful addition to -- to staff.”) (Prop. FOF 36).

²²⁸ See, e.g., Miller Test. at 2603:11-23 (“Q: Do you think Mr. Yancey -- in your experience, was he an honest man? A: Yes. Q: What -- in your own words, describe your views of Mr. Yancey. A: Any conversation that I ever had

As discussed above, no red flags were raised to Yancey that would have given him reasonable cause to believe the reasonably-designed systems and procedures were not being complied with. The red flags alleged by the Division were not red flags, but rather the *absence* of red flags. And the Division failed to meet its burden of proof with regard to each flag, often failing to advance any evidence or elicit any supporting testimony in support of its theory.

III. The Remedies Sought by the Division are Unsupported and Excessive.

In the alternative, should the Court conclude that Yancey failed to supervise Johnson or Delaney, the Division's request for sanctions should be denied.

The Division has requested a full bar, as well as civil penalties and disgorgement against Yancey.²²⁹ The Commission has authority to place limitations on, suspend, or bar a person associated with a broker-dealer if it determines that person has failed reasonably to supervise, with a view to preventing violations of federal securities statutes, rules, and regulations, another person who commits such a violation, and if such other person is subject to his supervision.²³⁰ In determining what sanctions to impose, the Commission considers the following factors: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infractions; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations; (5) the respondent's recognition of the wrongful nature of his conduct; and (6) the likelihood the respondent's occupation will present opportunities for future violations.²³¹ Courts also consider: the age of the violation; the degree of harm to investors and the marketplace resulting from the violation; the deterrent effect of the sanction; the public-at-large; the welfare

with Bill was always about doing the right thing. There was never a conversation that I had with him where he even missed a beat on making the right decision. He's a good man. Q: Is he someone that you could ever imagine putting profits ahead of compliance? A: No.") (Prop. FOF 85).

²²⁹ See Division's Prehearing Br. at 25-26.

²³⁰ Securities Exchange Act of 1934, 15 U.S.C. §§ 78o(b)(6)(A)(i), (b)(4)(E).

²³¹ *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981) (Prop. COL 38).

of investors; and standards of conduct in the securities industry business generally.²³² The severity of sanctions depends on the facts of each case and the *value* of the sanction in preventing a recurrence.²³³ The primary purpose in imposing sanctions is not to punish a respondent, but rather to protect the public.²³⁴

Disbarment is a drastic remedy that is not proportional to the conduct at issue. Yancey's supervisory conduct cannot be fairly characterized as egregious. As demonstrated above, Yancey was both diligent and engaged with his direct reports.²³⁵ Moreover, it is undisputed that Yancey was not aware that Stock Loan department was violating Rule 204, therefore lacking any element of scienter associated with the violations at issue.²³⁶

Furthermore, sanctions, in addition to the damage an adverse finding would inflict on Yancey's personal and professional reputation, are not in the public interest. The *only* specifically quantified benefit Penson gained from not timely closing out long sales of loaned securities at market open on T+6 was \$59,000 – approximately 0.08 percent of Stock Loan's total revenue during the relevant period.²³⁷ Given the evidentiary record and Yancey's undisputed lack of scienter, the risk of future violations is minimal. In Yancey's current position, he supervises two salespeople—a significantly different capacity than his role at Penson.²³⁸ Yancey is a clear champion for compliance and has an unblemished record after more

²³² See *In re Prime Capital Services, Inc., et al.*, SEC Admin. Proc. File No. 3-13532, Initial Decision Release No. 398, 2010 WL 2546835, at *48 (June 25, 2010) (Prop. COL 42).

²³³ *In the Matter of Steven Muth, et al.*, SEC Admin. Proc. File 3-11346, Initial Decision Release No. 262 (Oct. 8, 2005) (citing *Berko v. SEC*, 316 F.2d 137, 141-43 (2d Cir. 1963)) (Prop. COL 40).

²³⁴ *In the Matter of Stephen J. Horning*, Exchange Act Release No. 56886, 2007 SEC LEXIS 2796, at *24 (Dec. 3, 2007) (Prop. COL 39).

²³⁵ See, e.g., Delaney Test. at 1339:23-1340:1 ("Q: Was Mr. Yancey an accessible supervisor? A: He was. Q: Was he an engaged supervisor? A: He was."); Hasty Test. at 1701:25-1702:8; Wetzig Test. at 423:16-424:3; McCain Test. at 2178:5-7 (Prop. FOF 30).

²³⁶ Stip. FOF 43.

²³⁷ Stip. FOF 53, 80.

²³⁸ See Yancey Test. at 1813:19-25 ("Q: What is your current position? A: I'm the managing director for the First Southwest Company here in Dallas, Texas. Q: What do you do for First Southwest? A: I manage a very tiny sales force. Q: How large is your sales force? A: Just two salespeople.").

than 30 years in the securities industry.²³⁹ The consequences of suffering through these proceedings are more than adequate to punish Yancey and deter future violations.

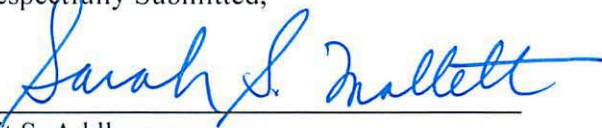
CONCLUSION

The evidence overwhelmingly establishes that Phil Pendergraft—not Bill Yancey—supervised Mike Johnson. Yancey delegated this responsibility to Pendergraft, and Pendergraft acknowledged and accepted the delegation unconditionally. The SEC concedes Yancey was not made aware of intentional Rule 204(a) violations and that they were actively concealed from him. There were no red flags raised to Yancey that would have given him reasonable cause to believe that Penson's systems and procedures were not being complied with. The purported red flags advanced by the Division are not red flags at all, but rather the absence of red flags. To hold Yancey liable on these facts would eviscerate long-standing concepts of regulatory supervision and would impose an insurmountable standard of diligence on every regulated CEO in the United States' securities industry. The claims against Yancey should be dismissed.

²³⁹ See Exs. 758, 240 (Yancey CRD); Yancey Test. at 1805:5-7 ("Q: When did your first enter the securities business? Was it out of Data Systems Design? A: Yes, it was. It was in July of 1983.").

December 19, 2014

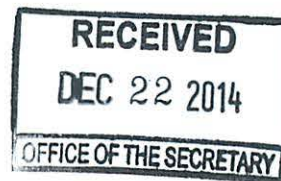
Respectfully Submitted,



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**ATTORNEYS FOR RESPONDENT
CHARLES W. YANCEY**

December 19, 2014



Via Hand Delivery

Lynn M. Powalski, Deputy Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Mail Stop 1090
Washington, D.C. 20549

Re: *In The Matter of Thomas R. Delaney II and Charles W. Yancey*, Administrative
Proceeding File No. 3-15873

Dear Ms. Powalski:

Enclosed for filing are originals and three copies of Respondent Charles W. Yancey's: (1) Post-Hearing Brief; (2) Proposed Findings of Fact and Timeline; and (3) Proposed Conclusions of Law.

By copy of this letter, I have served all parties of record. If you have any questions, do not hesitate to contact me at the number below. Thank you.

Sincerely yours,

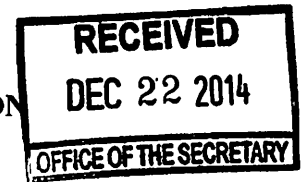
A handwritten signature in blue ink that reads "Sarah S. Mallett".

Sarah S. Mallett
Haynes and Boone, LLP
Direct Phone Number: (214) 651-5797
sarah.mallett@haynesboone.com

Encls.

cc: (w/enclosures)
Honorable Jason S. Patil, Administrative Law Judge (courtesy copy via email)
Polly Atkinson, Division of Enforcement, U.S. Securities and Exchange Commission (via email)
Brent Baker, Clyde Snow, Counsel to Delaney (via email)

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-15873

In the Matter of

**Thomas R. Delaney II and
Charles W. Yancey**

Respondents

**RESPONDENT CHARLES W. YANCEY'S
PROPOSED FINDINGS OF FACT AND TIMELINE**

Pursuant to the Court's Post-hearing Order, Respondent Charles W. Yancey ("Yancey"), by and through counsel, submits his Proposed Findings of Fact and Timeline. This submission also includes Stipulated Findings of Fact, which cite to the page(s) in the hearing transcript on which they were made, or to the Court's order on stipulations and transcript corrections in which they were endorsed (Admin. Proc. Rulings Release No. 2143 (Dec. 17, 2014)). Yancey's Proposed Findings of Fact are numbered Prop. FOF 1-103 and include citations to the specific portions of the record that support each fact.

Previously Stipulated Findings of Fact

- FOF 1. Delaney, 45, of Colleyville, Texas, was the CCO at Penson from at least October 2008 through April 2011. Delaney currently works in compliance at a registered broker-dealer. He holds Series 4, 7, 24, 27, 53, and 63 licenses. **Tr. 2287:20-23.**
- FOF 2. Yancey, 58, of Colleyville, Texas, was the President/CEO of Penson from at least October 2008 through February 2012. Yancey is currently a Managing Director at a registered broker/dealer. Yancey holds Series 7, 24, 55, and 63 licenses. **Tr. 2288:20-2289:2.**
- FOF 3. Penson was a North Carolina corporation with a principal place of business in Dallas, Texas. It was a broker-dealer registered with the Commission, which, from at least 2010 to 2012, was one of the largest clearing firms in the United States as measured by the number of correspondent brokers for which it cleared. Penson was a wholly-owned subsidiary of SAI Holdings, Inc., which in turn was a wholly-owned subsidiary of Penson Worldwide, Inc. ("PWI"). Penson filed a Form BDW, which was effective in October 2012, and then declared bankruptcy in January 2013. A bankruptcy plan implementing Penson's liquidation was approved in July 2013. **Tr. 2289:11-14.**
- FOF 4. Rule 204T/204 was adopted to, among other things, address prolonged failures to deliver. Rule 204T became effective on September 18, 2008 and Rule 204 became effective on July 31, 2009. **Tr. 2290:104.**
- FOF 5. The Depository Trust and Clearing Corporation ("DTCC") operates the National Securities Clearing Corporation ("NSCC"), a clearing agency registered with the Commission that clears and settles the majority of United States transactions in equities. When NSCC members purchase or sell securities on the exchanges, the exchanges send the trade information to the NSCC. NSCC operates the Continuous Net Settlement ("CNS"). NSCC member clearing firms receive reports that, as of at least close of business T+1, notify the firms of transactions scheduled to clear and settle by close of business T+3. CNS also sends reports to the firms listing net fails to deliver in each security as of T+3. **Tr. 2293:21-24.**
- FOF 6. At all relevant times, Penson was a clearing firm, i.e., a participant of a registered clearing agency and a member of NSCC. As a clearing firm, Penson had obligations under Rule 204(a) to close out CNS failures to deliver resulting from long sales no later than market open T+6. **Tr. 2294:8-11.**
- FOF 7. From October 2008 until November 2011, Penson failed to close out CNS failures to deliver resulting from long sales of loaned securities by market open T+6. The relevant long sales originated with securities held in customer margin accounts. Under the Commission's customer protection rule, Penson is permitted, subject to certain conditions and limitations, to re-hypothecate margin securities to third parties. Penson re-hypothecated margin securities according to the terms of the

Master Securities Lending Agreement (“MSLA”) developed by the Securities Industry and Financial Markets Association (“SIFMA”). **Tr. 2298:24-2299:3.**

- FOF 8. When a margin customer sold the hypothecated securities that were out on loan, Penson issued account-level recalls to the borrowers on T+3, i.e., three business days after execution of the margin customer's sale order. When the borrowers did not return the shares by the close of business T+3, and Penson did not otherwise have enough shares of the relevant security to meet its CNS delivery obligations, Penson incurred a CNS failure to deliver. **Tr. 2303:23-2304:8.**
- FOF 9. Michael Johnson, SVP Global Stock Lending Group, was included on the organizational charts of PWI, the parent company, rather than within Penson, which was then a registered broker-dealer. Licensed employees of Stock Loan were associated persons of the broker-dealer. **Tr. 2307:17-24.**
- FOF 10. Stock Loan initially attempted to comply with Rule 204T for long sales of loaned securities by recalling loans at the account level on T+3 and buying in the borrowers at market open T+6. However, because the MSLA gave the borrowers three full days (until close-of-business T+6) to return the shares, the borrowing counterparties pushed back against Penson’s attempted market-open T+6 buy ins. **Tr. 2308:6-9.**
- FOF 11. At least on some occasions, Stock Loan allowed CNS failures to deliver resulting from long sales of loaned securities to persist beyond market open T+6. At least on some occasions, Stock Loan personnel did not take steps, such as purchasing or borrowing securities, in order to close out Penson's CNS failure-to-deliver position. **Tr. 2315:11-19.**
- FOF 12. Delaney was Penson’s CCO when Rule 204T was implemented in September 2008. He continued in that position at Penson until April 2011. **Tr. 2319:24-2320:2.**
- FOF 13. As Penson’s CCO, if Delaney learned that associated personnel were not following the securities laws, he was required to take reasonable steps to investigate and report his findings to members of senior management where those persons reported. **Tr. 2320:17-23.**
- FOF 14. Delaney participated in Penson’s efforts to implement procedures in response to Rule 204T in October 2008 and to Rule 204 in July 2009. Delaney knew at all relevant times that Rule 204T/204 required Penson to close out CNS failures to deliver resulting from long sales by market open T+6. **Tr. 2321:7-10.**
- FOF 15. In December 2009, Penson’s Compliance Department conducted an NASD Rule 3012 internal audit of the Rule 204 close-out procedures, which had been in place at Penson from October 2008 forward. Penson’s compliance personnel sampled 113 CNS failures to deliver resulting from both long sales and short sales, and

found that Buy-Ins' procedures resulted in Rule 204(a) violations for 112 out of the 113 securities sampled. Delaney understood this NASD Rule 3012 audit had revealed failures relating to Buy-Ins' Rule 204(a) procedures that were anomalous during his tenure as CCO. **Tr. 2327:19-2328:7.**

- FOF 16. In July 2010, Delaney was at least copied on e-mail discussions between compliance and operational personnel about Stock Loan's non-compliant procedures for close-outs of CNS failures to deliver resulting from long sales of loaned securities. **Tr. 2331:5-12.**
- FOF 17. Penson's Buy-Ins handled close-outs of CNS failures to deliver resulting from transactions initiated by customers who sold short or customers who sold long but failed to provide the shares to Penson by settlement date. In those circumstances, Penson could pass along the cost of Rule 204T/204 compliance (i.e., borrowing or buying before market open) to the customer. Upon learning of Rule 204 deficiencies in Buy-Ins through the December 2009 audit, Delaney oversaw extensive remediation efforts. **Tr. 2336:17-2337:4.**
- FOF 18. Where CNS failures to deliver were not caused by the action of any customers, there was no one other than Penson to absorb the cost of the close-outs. **Tr. 2339:24-2340:4.**
- FOF 19. In January 2010, Penson compiled WSPs for delivery to FINRA as part of a FINRA Rule 1017 application. FINRA had been very clear with Delaney that they were going to be "poring over the WSPs with a fine-tooth comb." On January 25, 2010, Delaney forwarded a set of WSPs to Mr. Alaniz for comment before delivering the WSPs to FINRA. Mr. Alaniz responded that the WSPs Delaney sent him did not address Reg SHO as it pertained to 204. **Tr. 2353:17-2354:2.**
- FOF 20. Delaney was copied on at least one e-mail from Penson's Compliance Department delivering WSPs to FINRA as part of Penson's Rule 1017 application. A relevant WSP section had two parts: one titled "Close-Out Requirements for Fail (sic) to Deliver (SEC Rule 10b-21; Regulation SHO Rule 204)," and a subsequent part titled "Procedures Adopted in Accordance With Rule 204." The first part correctly articulated the regulatory requirement that CNS failures to deliver resulting from long sales had to be closed out by market open T+6. The section detailed Stock Loan's procedures for maintaining an easy-to-borrow list and providing locates procedures that were relevant to Penson's compliance with Rule 203, not Rule 204. The second part finished with a brief description of procedures designed to ensure close-outs of CNS failures to deliver resulting from short sales by T+4. **Tr. 2360:13-2361:7.**
- FOF 21. On March 31, 2010, Delaney met with Yancey to discuss Yancey's annual certification of Penson's compliance testing procedures. As part of that certification, Penson's Compliance Department prepared and presented an Annual

Report that, per Penson's WSPs, was to discuss Penson's "key compliance problems" for the period April 1, 2009 through March 31, 2010. At the March 31, 2010 meeting, an item of discussion was the results of the December 2009 audit showing the Rule 204(a) violations resulting from Buy-Ins' procedures -- a compliance failure that Delaney later characterized as "massive," "profound," and "anomalous." **Tr. 2370:24-2371:13.**

- FOF 22. Delaney's March 31, 2010 Annual Report appended to Yancey's certification did not reference ongoing, willful Rule 204(a) violations relating to long sales of loaned securities by Stock Loan. **Tr. 2372:23-2374:3.**
- FOF 23. On April 22, 2010, Mr. Gorenflo sent Penson's response to OCIE. The response stated: "[Penson] I would like to note that the majority of any Regulation SHO buy-ins are and have been covered by stock borrow or executing closing trades prior to the market open." **Tr. 2387:4-11.**
- FOF 24. Penson's April 22, 2010 response continued: "For instances where we were unable to complete buy-ins prior to market open, buy-ins were typically executed within 15 minutes of market open." **Tr. 2388:22-2389:3.**
- FOF 25. The December 2009 audit memorandum (Exhibit 70) reported that Buy-Ins' Rule 204(a) close-outs of short sales occurred "anywhere from 30 minutes to a 1 hour and 15 minutes after the market open" and that Buy-Ins' Rule 204(a) close-outs of long sales occurred "anywhere from 4 hours from the market open to up until 11 minutes of the market close." **Tr. 2389:4-13.**
- FOF 26. On May 10, 2010, a compliance officer forwarded the April 22, 2010 response to Delaney, stating "Tom, Attached is a copy of the most recent response, as well as a link to the examination folder." In October 2010, the junior compliance officer who signed the April 22, 2010 response forwarded the response to Delaney as part of Delaney's efforts to respond to the OCIE exam deficiency finding. The compliance officer mentioned is the deputy compliance officer, Ms. Holly Hasty. **Tr. 2390:18-23.**
- FOF 27. In June and July 2010, Delaney coordinated with his staff to formally approve an updated version of Penson's WSPs. **Tr. 2392:12-16.**
- FOF 28. Beginning in November 2008, OCIE conducted a review of Penson's Rule 204T procedures. In October 2010, OCIE issued Penson a deficiency letter reporting that OCIE had found Rule 204T(a) violations. The findings reported to Penson in the deficiency letter included findings that Penson had violated Rule 204T in connection with short sales. **Tr. 2392:14-22.**
- FOF 29. In its November 24, 2010 response to OCIE's deficiency findings, Penson stated the following: "Penson feels that the reasonable processes employed to close out

positions that were allegedly in violation of rule [sic] 204T were effective and performed as designed.” **Tr. 2394:2-5.**

- FOF 30. On November 8, 2010, Brian Gover, a supervisor in Buy-Ins, e-mailed Delaney, among others, a short, 1.5 page draft of selected responses to OCIE's findings. That draft contained the language: “Penson feels that the processes and procedures employed to close out positions that were in violation of Rule 204T were effective and performed as designed.” **Tr. 2399:5-14.**
- FOF 31. On November 15, 2010, a junior compliance officer shepherding the drafting process emailed Delaney a full draft of Penson’s responses to OCIE. That draft contained the language from the November 8, 2010 draft collection of selected responses regarding Penson’s Rule 204T processes and procedures. **Tr. 2399:21-24.**
- FOF 32. On November 19, 2010, Delaney e-mailed the junior compliance officer stating “Attached is my re-draft with a couple of additional notes.” Delaney's November 19, 2010 re-draft edited the November 15, 2010 draft (Exhibit 208). **Tr. 2403:11-17.**
- FOF 33. On March 31, 2010, Delaney personally emailed the certification and Annual Report to FINRA in response to its specific request for the documents. That same day, Penson’s compliance personnel uploaded the documents to Penson’s FINRA gateway and separately emailed the Annual Report to other FINRA personnel. On April 1, 2010, compliance personnel sent the Annual Report to the Chicago Board Options Exchange (“CBOE”). In September 2010, compliance personnel sent the Annual Report to the National Stock Exchange, Inc. (“NSX”) in response to an information request. **Tr. 2406:10-13.**
- FOF 34. On April 8, 2010, the Commission’s Office of Compliance Inspections and Examinations (“OCIE”) informed Penson it had learned Penson was having problems executing close outs at market open and asked for an explanation. On April 14, 2010, a junior Penson compliance officer asked OCIE to clarify how it had learned about the potential close-out problems. That same day, OCIE sent the junior compliance officer, and Delaney the following clarification and request for information: “During staff’s review of fails to deliver and conversations with the firm regarding 204T compliance, Penson represented and in documents produced evidenced that the firm did not always buy-in to close-out a fail to deliver position at the market open. The reason the firm provided for not buying-in at the open was because of manual processes and system limitations. Q. What is the system limitations that prevent the firm from executing buy-ins at the market open? Has the firm fixed the system limitations and manual processes to now execute buy-ins at the market open? If so, please provide the date the firm corrected this issue.” **Tr. 2406:20-23.**

- FOF 35. On November 24, 2010, Delaney was copied on an email seeking final review of the letter before delivery to OCIE. That draft, and the final draft delivered to OCIE on November 24, 2010, contained the exact language from Delaney's November 19, 2010 draft. **Tr. 2407:11-14.**
- FOF 36. The chief compliance officer (CCO) is responsible for establishing and maintaining the supervisory system policies and procedures, other than financial and operations procedures. **Tr. 2409:9-13, 18-22.**
- FOF 37. From 2009 to 2011, the Registered Representative Supervisory Matrix listed Bill Yancey under the column titled Regulatory Supervisor with regard to Michael Johnson. **Tr. 2415:12-17.**
- FOF 38. Michael Johnson was the individual with primary responsibility within Stock Loan for compliance with Rule 204(a) procedures. **Tr. 2415:18-22.**
- FOF 39. A few months later, in July 2010, Delaney was copied on an e-mail chain between Buy-Ins, Stock Loan, and compliance personnel. In the final e-mail of the chain, one of Penson's junior Compliance Specialists stated the failure to deliver positions "should be flat by the end of the day" and "preferably this should be completed prior to or at market open." **Tr. 2422:4-13.**
- FOF 40. On August 2, 2010, Delaney met with Yancey to discuss the status of the efforts to remediate Buy-Ins' Rule 204(a) deficiencies. Consistent with Delaney's actions during the March 31, 2010 meeting, Delaney and Yancey did not discuss Rule 204(a) violations relating to long sales of loaned securities. **Tr. 2424:15-23.**
- FOF 41. Michael Johnson, the Senior Vice President of Stock Loan, was an associated person of Penson. He had primary authority and responsibility within Stock Loan for its operational practices and for the Department's WSPs, which WSPs were incorporated into Penson's WSPs. The Senior Vice President of Stock Loan knew that Rule 204T(a)/204(a) required Penson to close out CNS failures to deliver for long sales, including long sales of loaned securities, by market open T+6. From October 2008 through November 2011, the Senior Vice President of Stock Loan knew Penson was at times violating Rule 204T(a)/204(a) in connection with long sales of loaned securities. **Tr. 2427:15-2428:4.**
- FOF 42. Yancey was Delaney's supervisor throughout the pertinent period. **Tr. 2429:10-13.**
- FOF 43. Yancey was not aware that Penson's Stock Loan Department was violating Rule 204. **Tr. 2436:12-15.**
- FOF 44. Yancey took no steps regarding how Stock Loan's Rule 204 procedures may have been contributing to Penson's Rule 204 deficiencies. **Tr. 2430:8-2436:20.**

- FOF 45. Penson's WSPs, effective as of March 31, 2010, contained a section titled "Annual CEO Certification (RULE 3130): CEO and CCO Mandated Meeting." Those procedures identified Yancey, as CEO/President, and Delaney, as CCO, to be the relevant Designated Supervisory Principals. The procedures required as follows: "The CCO will prepare and provide the CEO (or equivalent officer) with an Annual Report that includes a review of [Penson]'s Supervisory System and Procedures and key compliance issues. The CCO will meet with the CEO to discuss and review the report and will meet at other times, as needed, to discuss other compliance matters." The procedures further required Yancey to certify, among other things, that "[c]ompliance processes are evidenced in a written report reviewed by the CEO, CCO, and other appropriate officers and submitted to the Board of Directors and Audit Committee, if any." **Tr. 2438:1-6.**
- FOF 46. At the conclusion of that meeting, Yancey signed CEO Certifications per FINRA Rule 3130 and NYSE Rule 342.30. Those certifications included copies of Penson's Annual Report. Consistent with the WSPs' requirement that the report discuss "key compliance issues," the March 31, 2010 Annual Report contained a section titled "identification of significant compliance problems." But that section of the report did not specifically discuss Penson's Rule 204 deficiencies as identified in the December 2009 audit. **Tr. 2441:18-2442:5.**
- FOF 47. Yancey and Delaney, among others, were recipients on the e-mail distributing the initial draft of Penson's response to a Rule 204T exam by OCIE on November 8, 2010, and then on November 24, 2010, Delaney and Yancey received the draft for their final review before delivery to OCIE. **Tr. 2442:12-17, 2442:23-2443:2.**
- FOF 48. Yancey allowed the November 24, 2010 letter to be delivered to OCIE without making any edits to it. **Tr. 2444:2-6.**
- FOF 49. During the relevant time period there were at least 1,500 Rule 204T(a)/204(a) violations by PFSI relating to long sales of loaned securities. **Tr. 2468:25-2469:4.**
- FOF 50. During the relevant time period PFSI cleared at least 1 billion securities transactions. **Tr. 2469:5-8.**
- FOF 51. There were a total of 83.6 million long sale transactions by PFSI during the relevant time period that could be potentially associated with loaned shares. Out of these 83.6 million long sale transactions, only 0.12 percent could be potentially associated with a negative CNS position that was a Rule 204(a)/204T(a) violation. **Tr. 2470:11-18.**
- FOF 52. The 1,500 Rule 204T(a)/204 negative CNS positions identified as violations represented only approximately 0.68 percent of the total number of Penson's CNS net sale settling positions potentially associated with loaned shares. **Tr. 2470:11-2471:1.**

- FOF 53. During the relevant time period the only specifically quantified benefit PFSI gained from not timely closing out at market open on T+6 is \$59,000. **Tr. 2475:4-8.**
- FOF 54. Penson violated Rule 204T(a)/204(a) of Regulation SHO. **Tr. 2476:16-18.**
- FOF 55. Michael Johnson of Dallas, Texas, was the senior vice president of Penson Worldwide, Inc's ("PWI") securities lending department from at least October 2008 until June 2012. In that position Johnson oversaw securities lending activities at PFSI. Johnson was associated with PFSI between 2004 and 2012. Johnson held Series 7, 24, 27, and 63 licenses. **Tr. 2479:19-25, 2480:4-13.**
- FOF 56. Mr. Delaney gave notice to Penson that he was resigning as chief compliance officer and leaving Penson to pursue other employment in mid-March 2011. **Tr. 2481:4-6, 10-13.**
- FOF 57. Mr. Delaney, in fact, left employment at Penson at the end of April 2011. **Tr. 2481:14-15, 23-25.**
- FOF 58. The relevant period for the Division's claim against Delaney for aiding and abetting Penson violations of Rule 204(a) of Regulation SHO runs from October 1st, 2008 until approximately February 15th, 2011. **Tr. 2482:17-20, 2482:24-2483:2.**
- FOF 59. For the alleged violations of Rule 204 for long sales of loaned securities in this case, the Division of Enforcement is not alleging that a failure to recall on T+2 or failure to close out at any time prior to market open of T+6 is a violation. **Tr. 2484:11-15, 21-24; 2486:4-11, 21-24.**
- FOF 60. During Eric Alaniz's initial meetings with Stock Loan personnel related to his 3012 testing of Penson's 204 compliance, no Stock Loan personnel told Alaniz that Stock Loan was deliberately failing to comply with Rule 204. **Tr. 2487:1-6, 8-11.**
- FOF 61. Brian Gover believed that the following language that he authored was accurate, both when drafted and as of the date that he testified at the final hearing: "Penson feels that the processes and procedures employed to close out positions that were in violation of Rule 204T were effective and performed as designed. Our [presumably meaning Penson] current procedures as they relate to Rule 204 are effective and designed to ensure that all short sales and sales not long are covered either through stock borrow or market action prior to the open on S+1." **Tr. 2491:9-19, 2491:25-2492:4.**
- FOF 62. During all the relevant time periods Eric Alaniz was a compliance officer at Penson Financial Services, Inc. **Tr. 2494:8-10, 13-16.**

- FOF 63. During all relevant time periods Eric Alaniz had been delegated primary responsibility for conducting the testing required by NASD Rule 3012 and was the one who primarily conducted such testing. **Tr. 2494:18-22, 2494:25-2495:2.**
- FOF 64. Penson undertook substantial remediation efforts following the November and December 2009 testing by Eric Alaniz of Penson's Rule 204 compliance, and these remediation efforts began at least as early as January 2010. **Tr. 2495:20-24, 2496:16-20.**
- FOF 65. Holly Hasty was, at least until March 2011, the deputy chief of compliance at Penson Financial Services, Inc. **Tr. 2502:18-20, 23-25.**
- FOF 66. Holly Hasty took over as chief compliance officer of Penson in March 2011. **Tr. 2503:1-2, 5-8.**
- FOF 67. Violations of Rule 204 by Stock Loan continued after Delaney left Penson. **Tr. 2503:10-11, 16-19.**
- FOF 68. Violations of Reg SHO Rule 204(a) by Stock Loan continued after the meeting arranged by Delaney between Penson's Stock Loan department and Penson's outside counsel. **Tr. 2503:20-23, 2504:1-3, 5-15.**
- FOF 69. Tom Delaney could not discipline, hire, or fire members of Penson's Stock Loan Department. **Tr. 2504:16-18, 21-23.**
- FOF 70. Members of Penson's Stock Loan Department at all times knew that Rule 204T or 204 required them to close out all long sale transactions by market open at or before market open on T+6. **Tr. 2505:1-4, 7-9.**
- FOF 71. From at least August 2008 to 2011, Michael Johnson was a PWI employee. **Tr. 2506:3-4, 9-11.**
- FOF 72. During the relevant time period 2008 to 2011 Penson's compliance department, under the direction of Yancey and Delaney, grew to over 23 employees. **Tr. 2506:12-15, 2507:16-19.**
- FOF 73. Phil Pendergraft was a licensed principal and registered representative associated with PFSI. **Tr. 2507:20-22, 16-19.**
- FOF 74. Dan Son was a licensed principal and registered representative associated with PFSI. **Tr. 2508:4-5, 14-16.**
- FOF 75. During the relevant period Phil Pendergraft was an executive vice president of PFSI. **Tr. 2508:17-18, 22-25.**

- FOF 76. During the relevant period Phil Pendergraft maintained a desk inside in Mr. Yancey's office. **Tr. 2510:12-14, 17-19.**
- FOF 77. Following meetings in January and March 2010, Mr. Yancey was told that the 204 testing results were the subject of prompt remediation and that the relevant departments were cooperating. **Tr. 2512:20-23, 2513:2-4.**
- FOF 78. The December 2009 audit and June 2010 follow-up 204(a) audit results related only to the Buy-Ins Department. **Tr. 2516:1-3, 7-9.**
- FOF 79. For the relevant time period Penson's Stock Loan revenue was approximately 77 million. **Tr. 2519:8-12, 16-19.**
- FOF 80. The total calculated benefit to Penson from the 204(a) violations at issue is only approximately 0.08 percent of Stock Loan's total revenue during the relevant period. **Tr. 2520:18-21, 2520:24-2521:1.**
- FOF 81. Phil Pendergraft interacted with Mike Johnson on a regular basis during the relevant period. **Tr. 2527:12-14, 18-20.**
- FOF 82. Phil Pendergraft had sufficient knowledge and experience to supervise Michael Johnson. **Tr. 2527:21-22, 2528:1-3.**
- FOF 83. Michael Johnson believed he reported to Phil Pendergraft during the relevant period. **Tr. 2529:7-8, 2529:22-2530:5.**
- FOF 84. During 2008 to 2011, Michael Johnson believed he was supervised by and reported to Phil Pendergraft and/or Dan Son. **Tr. 2552:7-9, 11-13.**
- FOF 85. Tom Delaney received and reviewed guidance from Morgan Lewis about Rule 204T and Rule 204, which referenced the adopting releases for Rule 204T and Rule 204. **Tr. 2552:20-23, 2553:2-4.**
- FOF 86. During the relevant time period, Penson's Buy-Ins Department was located on the 14th floor and the Stock Loan Department was located on the 19th floor. **Tr. 2571: 3-4.**
- FOF 87. During the relevant time period, Phil Pendergraft and Dan Son shared an office. **Tr. 2571:4.**
- FOF 88. Phil Pendergraft periodically met with Bill Yancey to discuss Michael Johnson's performance. **Tr. 2571: 4-5.**
- FOF 89. "0234" was a NSCC participant or account number for PFSI and represents information related to PFSI. Prior to June 28, 2010, "0158" was a NSCC participant or account number for Ridge Clearing and represents information

related to Ridge Clearing. After June 28, 2010, “0158” became an additional NSCC account of PFSI. **Dec. 17, 2014 Order on Stipulations and Transcript Corrections (“Order on Stipulations”); Tr. 86:10-11; 817:16-17.**

- FOF 90. Bill Yancey held quarterly FINRA Rule 3012 meetings, which exceeds FINRA’s annual requirement. **Order on Stipulations; Tr. 171:14-17; 835:3-5.**
- FOF 91. Stock Loan did not change its Rule 204 close out practices after consulting outside counsel in February 2011. **Order on Stipulations; Tr. 403:8-11.**
- FOF 92. Persistent failure to deliver positions can be consistent with Rule 204 compliance. **Order on Stipulations; Tr. 1075:13-16.**
- FOF 93. Brian Gover, Brian Hall, and Rudy DeLaSierra signed cooperation agreements with the Division related to this matter. **Order on Stipulations; Tr. 125:14-18; 342:8-13; 1126:10-12.**
- FOF 94. Penson provided organizational charts to regulators. **Order on Stipulations; Tr. 1750:10-13.**
- FOF 95. Bill Yancey routinely met with Mr. Delaney. **Order on Stipulations; Tr. 1339:1-19; 1840:9-14; 2178:21-25.**
- FOF 96. Eric Alaniz distributed the invitation list for the March 31, 2010 Rule 3012 meeting. **Order on Stipulations; Tr. 1359:23-1360:2; 1883:7-8; Ex. 507.**
- FOF 97. Michael Johnson told Bill Yancey and other Penson senior management that he had limited availability to attend meetings during market hours. **Order on Stipulations; Tr. 1842:13-21; 539:3-12.**
- FOF 98. NASD Rule 3010 requires each registered representative be appropriately assigned to a registered principal, e.g., an individual who holds a Series 24 or Series 27 license. **Order on Stipulations; Tr. 1951:4-9; 2588:21-2589:23.**
- FOF 99. On average, Penson’s Compliance Department received between approximately 1,100 and 1,500 regulatory requests and state agency subpoenas per year. **Order on Stipulations; Tr. 2572:10-23.**
- FOF 100. At Penson, the employee that dealt with licensing and registration was also the individual responsible for keeping and maintaining the Registered Representative Supervisory Matrix. During the relevant time period, Kim Miller was one of the individuals responsible for maintaining the Registered Representative Supervisory Matrix. **Order on Stipulations; Tr. 2574:16-23.**
- FOF 101. When Penson received an examination notification or prepared an exam response, the Compliance Department’s typical practice was as follows: the Compliance

Department distributed the notification to the business units, senior management, and the legal department; held an initial meeting with the recipients of the notification to determine assignments for the response among the business units; compiled a response draft document with input from, and substantive sections drafted by, the business units by assignment; circulated responses internally among the Compliance Department, business unit heads, senior management, the legal department and sometimes outside counsel; and, once a final consensus was reached, sent the response to the regulatory entity. **Order on Stipulations; Tr. 1735:4-1736:16.**

- FOF 102. During the relevant time period, Michael Johnson and Tom Delaney were registered representatives associated with PFSI. **Order on Stipulations; Exs. 241, 242.**
- FOF 103. PWI was a public company; it had a number of subsidiaries, including: PFSI; Penson Financial Services, London; Penson Financial Services, Canada; and Nexus Technologies. **Order on Stipulations.**
- FOF 104. Mike Johnson was charged by the Commission for willfully aiding and abetting the Rule 204 violations at issue in this matter, and settled his case on a neither admit nor deny basis. **Order on Stipulations.**
- FOF 105. Rudy DeLaSierra began working at PFSI in March 2000. He joined the Stock Loan department in June 2000. He became Vice President of Stock Loan in approximately 2006. **Order on Stipulations.**
- FOF 106. Lindsey Wetzig began working at PFSI out of college in March 2000. In 2004, he joined the Stock Loan group. In approximately 2006 or 2007, he was promoted to Operations Manager of the Stock Loan group. **Order on Stipulations.**
- FOF 107. Kim Miller was a PFSI compliance department employee from 2000 until 2012. One of Kim Miller's responsibilities was to provide information in response to requests from regulators and other outside sources. **Order on Stipulations.**
- FOF 108. Bart McCain began working at PFSI in 2006. He was PFSI's chief administrative officer, and also served as PFSI's chief financial officer for a time. McCain also served as the PWI interim treasurer in 2011 and interim chief financial officer in 2012. **Order on Stipulations.**
- FOF 109. Brian Gover began working at PFSI in April, 2007. Over time he managed several departments, including the buy-ins department. In April 2012, Gover moved into the compliance department at PFSI. He is currently the Chief Compliance Officer of Apex Clearing. **Order on Stipulations.**
- FOF 110. Summer Poldrack and Angel Shofner were PFSI employees in the Buy-ins Department during the relevant time period. **Order on Stipulations.**

- FOF 111. No PWI entity other than PFSI had close out obligations under Rule 204. **Order on Stipulations.**
- FOF 112. Yancey had supervisory responsibility for Delaney. **Order on Stipulations.**
- FOF 113. The Rule 204 December 2009 Audit was discussed in the March 31, 2010 quarterly 3012 CEO certification meeting, which was held on the same day that Yancey signed the 2010 Annual CEO Certification. **Order on Stipulations.**
- FOF 114. Yancey personally signed the Annual CEO Certification. **Order on Stipulations.**
- FOF 115. Yancey was aware that the CEO Certification and Summary Report were sent to regulators. **Order on Stipulations.**
- FOF 116. Providing locates, borrowing securities, and lending securities, were functions of PFSI's Stock Loan Department rather than Penson Worldwide. **Order on Stipulations.**
- FOF 117. Sometime prior to the implementation of Rule 204T, Johnson became the PWI Senior Vice President for Global Stock Lending, responsible for all of Penson's worldwide stock lending operations. **Order on Stipulations.**
- FOF 118. Until Johnson was promoted to PWI Senior Vice President for Global Stock Lending, Yancey was Johnson's supervisor. **Order on Stipulations.**
- FOF 119. Johnson received approximately 300 e-mails per day when he was PWI Senior Vice President for Global Stock Lending. **Order on Stipulations.**

Yancey Proposed Findings of Fact

Prop. FOF 1. Reg SHO Rule 204 is a complex, technical, and operational rule.

- Gover Test. at 138:7-138:9 (“Q: Would you describe Rule 204 -- I guess let’s start Reg SHO generally, as -- as simple? A: No, it’s very complex.”); Gover Test. at 163:22-164:12 (“Q: Mr. Gover, you testified a couple of times earlier Rule 204 is a complex rule, correct? A: Yes, it is. Q: It’s a technical rule; is that fair? A: Yes. Q: As a lawyer with maybe not the understanding that you have, if I were to say there is nothing technical about Rule 204, would you disagree with me? A: Yes. Q: As a lawyer, if I were to say, look, there’s nothing confusing about Rule 204, would you disagree with me? A: Yes. Q: And if I were to say, you know, there’s nothing ambiguous about Rule 204, would you disagree with me? A: Yes.”); DeLaSierra Test. at 304:8-10 (“Q: . . . Would you agree that Rule 204 is highly technical? A: Yes.”); Paz Test. at 2053:24-2054:12 (“Q: . . . In your opinion, is Rule 204 a technical rule? A: Yes. Q: Why do you have that opinion? A: I have an opinion from my experience with the rule. I believe that the Commission’s statements and publicly available information on the website also speak to the technicalities of the rule. It deals with a complex process. While seemingly simple, the actual operation of how things is affected is highly technical and has been the subject of quite a bit of guidance. Q: Is Rule 204 an ambiguous rule? A: Yes. . . .”).

Prop. FOF 2. Frequent testing by regulators on the same or similar issues or regulatory rule is not necessarily indicative of systemic compliance issues.

- Gover Test. at 187:11-18 (“ . . . There’s some topics you know you’re going to get – you’re going to get tested on these every year, regardless of your performance. I know every single year I’m going to get tested on Reg SHO. I know every single year we’re going to be tested on 15c3-3. I know every year I’m going to get a TAMMS exam. So no, that in itself does not – there’s no other -- you don’t have to draw some conclusion aside from the fact that, gee, if they’re testing on this every year, it’s probably pretty important.”).

Prop. FOF 3. Stock Loan’s Sendero system was reliable and accurate.

- DeLaSierra Test. at 234:22-25 (“Q: All right. We’ve talked for a minute -- for a while now about Sendero. What was your sense of Sendero’s accuracy, reliability? A: I felt it was very reliable.”); Wetzig Test. at 365:14-17 (“Q: And in your experience, was it -- did it seem to be an accurate system at telling you whose responsibility, whether it

was a short or a long? A: Yes. Sendero was a very accurate system.”), 374:18-20 (discussing Sendero “Q: Do you have a sense of -- can you put that in a range of accuracy, how accurate it seemed to be? A: I would say 95 percent.”).

Prop. FOF 4. Sendero was updated around 2010.

- Wetzig Test. at 372:25-373:12 (“Q: Did there ever come a point in time where Sendero was reprogrammed to change when that recall was happening? A: Yes. Q: And -- and when -- to the best of your memory, about when did that occur? A: I would say, maybe, 2010. Q: Do you recall how the reprogramming worked? I mean, what happened? What -- what did you do to reprogram Sendero? A: So our programmer, Matt Battaini, programmed Sendero so that we could see what we needed to recall on T+2 instead of T+3.”).

Prop. FOF 5. The June 2010 follow-up Rule 204 testing showed significant improvement. Alaniz also conducted a spot check with Summer Poldrack, and the results indicated 100% compliance.

- Alaniz Test. at 859:6-7 (“Q: And did that June test show improvement? A: Yes, it did.”), 860:3-9 (“Q: So there was an improvement in the number of fails; is that correct, or percentage of fails? A: Yes . . . And pretty significant? . . . A: Yes.”), 860:24-861:10 (“Q: And she told you they were getting 100 percent compliance? A: Correct. Q: And, in fact, she pulled up some records in the system to check that? A: I did a random search on their internal site to review everything that had been bought in for certain days throughout a certain week, and everything was in line with what she had told me.”); Gover Test. at 172:11-17 (“Q: And then the -- the issues that were identified in the December audit were actually re-tested again in June of 2010; am I correct? A: I believe that’s correct. Q: And the results showed significant improvement? A: That’s correct.”); *compare Exs. 85 and 610.*

Prop. FOF 6. Bill Yancey delegated supervision of Michael Johnson to Phil Pendergraft in approximately August 2008.

- Yancey Test. at 951:6-8 (“Q: And then -- and then your position, and certainly what we’re here to talk about at the hearing is that in approximately August of 2008, that’s when you delegated to Phil Pendergraft? A: Fully delegated, fully accepted.”); Gardner Test. at 1149:3-16 (“Q: Prior to August 2008, who did Mike Johnson report to? A: Bill Yancey. Q: And who was Mike Johnson supervised by? A: Bill Yancey. Q: Was Mike Johnson moved into the PWI organization at some time? A: Yes, he was. Q: Do you know about when that was?

A: August of 2008. Q: Did Mike Johnson remain in the PWI organization after that period of time? A: Yes, he did. Q: And that would have been the time frame of August 2008 through November 2011? A: Yes. Q: Who was Mike Johnson's supervisor during the time period August 2008 through November of 2011? A: Phil Pendergraft."), 1151:2-5 ("Q: And I believe you testified earlier Mike Johnson reported to Phil Pendergraft from that point forward? A: Yes."); Delaney Test. at 1332:3-7 ("Q: Okay. Did you understand that with that transition, that Mr. Yancey and Mr. Pendergraft had agreed that Mr. Pendergraft would be the supervisor for Mr. Johnson? A: Yes."); McCain Test. at 2182:5-16 ("Q: How did Mike Johnson come to be assigned to or report to Mr. Pendergraft, to your knowledge? A: The -- Stock Loan needed somebody that could -- understood what they did, and my recollection is that Phil and Bill discussed who would manage Stock Loan and who was the best suited to manage Stock Loan, and Phil was -- was chosen to be that person. Q: How did you come to that understanding? A: That's like asking why water is wet. That's just -- that's just the way it was. You know, Phil told me and -- and clearly, Mike made it clear to everybody that he reported to Phil. There wasn't any question as to who reported to who. If anybody had any question, Mike would set you straight real fast."); Ex. 555 (PFSI Executive Team chart showing Michael Johnson under Bill Yancey pre-2008); Ex. 571 (organizational chart showing Michael Johnson under Phil Pendergraft in Jan. 2009); Ex. 608 (email from Phil Pendergraft to Dawn Gardner directing her to move Mike Johnson to PWI payroll).

Prop. FOF 7. Employees at Penson relied on Penson's organizational charts, not the Registered Representative Supervisory Matrix, to determine supervisors and supervisory relationships.

- Miller Test. 2597:19-24 (discussing the supervisory matrix, "Q: Are you aware of anyone at Penson that was ever confused from this document, or as a result of this document, about who supervised Mike Johnson? A: I wouldn't think so. I would think that people at the firm typically referred to a human resources org chart rather than this document."); Delaney Test. at 1215:11-16 ("Q: And when you wanted -- if in your work, if you need to know who reported to whom, was there anything that you referred to? A: There were documents that the -- that the company had that gave us information about who reported to who, the org -- company org charts."), 1216:3-1216:22 ("Q: Is that a document you relied on much when you were Chief Compliance Officer? A: No. Q: Why not? A: We had -- these org charts were -- were -- they were well-communicated. They were well-published. They were well-understood. Those were the documents that the company relied on. Q: Did you ever feel as Chief Compliance

Officer, that there was any ambiguity in -- in who people supervised or -- or were supervised by? A: No. Q: And what clarified or what eliminated ambiguity? A: Again, these were well-published org charts that -- that were, you know, published both on Internet. They were -- they free-flowed throughout the organization. Those -- those were the documents the company relied on. There just -- there was no ambiguity about who reported to whom.”), 1345:2-1245:6 (“Q: Was the Supervisory Matrix or Matrices that you’ve seen so far during this trial, was that a document that you used in your day-to-day operation to know who was the supervisor of another? A: No.”); Hasty Test. at 1747:20-25 (discussing the registered representative supervisory matrix, “Q: Is this a document that you relied on to know who someone’s supervisor was? A: No. Q: Is this a document that you used in your day-to-day compliance responsibilities? A: No.”), 1748:1-3 (“Q: If you wanted to know who someone’s supervisor was, what document would you reference? A: I would use the org charts.”); Gardner Test. at 1165:3-22 (“JUDGE PATIL: I have a question. How many times have you seen an organization chart like that before? THE WITNESS: The one that was just in front of me? JUDGE PATIL: That chart or something substantially similar. When is the first time you ever saw an organization chart like that? MR. BREAU: Like this one on the screen? JUDGE PATIL: Yeah, like that one on the screen. THE WITNESS: 19 years ago. I was there for 19 years. JUDGE PATIL: Okay. And how often did you have an opportunity to see a chart like that after 19 years ago? THE WITNESS: Weekly at least. JUDGE PATIL: Throughout the whole -- your tenure at Penson? THE WITNESS: Pretty much, yes.”); McCain Test. at 2188:7-12 (discussing the supervisory matrix, “Q: How did you use this document? A: I didn’t. I didn’t. This is -- I would -- if I wanted know who somebody reported to, I would ask, ask Bill, and ask -- in operations, I would ask John Kenny, or I would try to call up a current org chart. I didn’t know this document existed.”); Alaniz Test. at 862:4-18 (“Q: Is this something that you used for any purpose? A: I did not use it. Q: Do you know whether it was used in the Compliance department -- A: I believe it -- Q: -- for any purpose? A: I’m sorry. I believe it was used in conjunction with finding or assigning continuing education -- continuing education to individuals based on their licensing. Q: Okay. Did you use that document if you needed to know who someone reported to or who was someone’s supervisor? A: No. Q: Is it a document that you went over with Bill Yancey? A: No”); Yancey Test. at 1837:24-1839:12 (“... Q: Had you ever seen [the supervisory matrices] prior to this proceeding being initiated? A: Not that I recall. Q: Did anybody ever tell you how it was used or for what purpose it was being kept? A: No. Q: Do you have any belief as you sit here as to why you didn’t read or review the e-mails with those matrices attached? A: Well, they -- they came from Compliance. I can

only speculate why -- what that process was. I don't -- since I don't remember them. But I thought that they had something to do with licensing and registration. They came from Kim Miller, who was in licensing and registration, and I thought they had something to do with, you know, setting forth that people had the appropriate licenses, and that's my -- what I believe that it was. Q: Were you aware that the matrix was ever sent to regulators? A: As I sit here today, I'm aware of it for certain. At the time, I didn't know its primary use. Like I said, no one ever sat down with me and said, This is important; we use it for certain purposes; we would like you to understand it and go over it. No one ever did that with me. . .").

Prop. FOF 8. After Tom Delaney became aware of the Rule 204 issues related to the Stock Loan Department in early 2011, he escalated the issues to outside counsel.

- Delaney Test. at 699:24-700:18 ("Q: When did you first find out that Stock Loan had a role in closing out long sales? A: . . . it would have been no earlier than that February or that March 2011 letter."), 1310:4-1311:6 ("Q: You have Exhibit 378 in your binder. Do you see that document? A: I do. Q: And what is that? A: That's an e-mail from Mark Fitterman, an attorney for Morgan Lewis, sent to me on Thursday, February 10th, 2011; subject, attorney-client privileged communication, Reg SHO. Q: If you could go back to the first e-mail in this chain. Who is that e-mail from and who is it to? A: The first e-mail is to Andy Koslow, with a copy to Holly Hasty, from me. Q: And if you were to look at -- so I think two of the last three paragraphs there, the second-to-last and third-to-last paragraphs, does that -- does that describe this dispute that you had with Mr. Johnson? A: The last three? It that what you said? Q: Yeah, on Page 3 of this document. Does that describe the dispute? A: Yes. I think that describes the dispute, yes. Q: And accurately, as far as you're concerned? A: Yes. Q: All right. And you sent that to Mr. Koslow, the general counsel? A: I did. Q: And then did you send it on after that to the attorneys at Morgan Lewis? A: I did.").

Prop. FOF 9. During the period 2008-2011 and for the period that Mike Johnson reported to Phil Pendergraft, Phil Pendergraft supervised Mike Johnson with respect to the following activities:

- A. Evaluated and review performance of Mike Johnson;**
 - Ex. 565.
- B. Disciplined Mike Johnson;**
 - Ex. 668.

- C. Determined, with input from others, Mike Johnson's base compensation and bonus;**
 - Exs. 608, 646, 662, 809.
- D. Approved, with input from others, Mike Johnson's budget for the compensation of all PWI subsidiary stock lending groups;**
 - Exs. 506, 521, 590, 639, 684.
- E. Received input on issues with respect to staffing regarding Mr. Brian Hall and Mr. Rudy DeLaSierra;**
 - Exs. 655, 664, 678.
- F. Maintained authority to overrule or override any decisions of Mike Johnson;**
 - Exs. 783, 788, 790.
- G. Had authority to advise regarding customer relations issues;**
 - Exs. 707, 741, 793, 794, 795, 801.
- H. Instructed Mike Johnson regarding PFSI firm financing and lending balances;**
 - Exs. 515, 607, 780, 790, 803, 804, 806.
- I. Instructed Mike Johnson to report on revenue and expenses of PFSI stock loan;**
 - Exs. 527, 611, 627, 791, 797.
- J. Approved business development and client relation plans and budgets of Mike Johnson;**
 - Exs. 502, 591.
- K. Approved Mr. Johnson's travel budget and question his expenses;**
 - Exs. 517, 550.
- L. Received information regarding Mike Johnson's need for time off and vacation schedule.**
 - Exs. 548, 557, 605, 688, 710, 709.
- Pendergraft Test. at 1529:6-1534:1 (agreeing that he performed each of the above referenced list of activities).

Prop. FOF 10. Phil Pendergraft approved Mr. Johnson's activities related to regulatory and compliance issues, including Regulation SHO.

- Johnson Test. at 541:25-542:5 ("Q: Did you talk with Mr. Pendergraft about Reg SHO? A: Yes. Q: Would Reg SHO only have applicability to the broker-dealer Stock Loan function? A: Yes."); Exs. 94, 551, 563, 638, 710, 730, 810, 813, 814; *see also Johnson Test. at 544:2-10* ("Q: . . . And you said, I think that Reg SHO was, hey, Phil, I'm sitting here, and you're not doing anything about it. Do you know the rules, question mark. So I need a check for \$150,000 to do something with it to try and work with Jill Zacha and other people -- it wasn't all me -- and to put some in place to comply with Reg SHO. Do you recall that? A: I do.").

Prop. FOF 11. Bill Yancey routinely checked in with Phil Pendergraft regarding the issues described in items A-L in Proposed Finding of Fact #9 and acted reasonably in ensuring that the stock lending group and Mr. Johnson were properly conducting business in accordance with the securities laws.

- Pendergraft Test. at 1537:5-10 ("Q: Fair enough. Mr. Yancey routinely checked in with me regarding those activities, and I believe acted reasonably in ensuring that Mr. Johnson and the Stock Lending group were properly conducting business in accordance with the securities laws. A: I believe that."), 1540:10-20 ("Q: In all of my dealings with Mr. Yancey he always placed compliance at the forefront of PFSI's business practices. A: Yes. Q: I observed him properly and diligently supervising the PFSI business by assigning responsibility as appropriate and following up. A: Yes, sir. Q: In that regard, I believe that Mr. Yancey acted as a reasonable CEO of a broker-dealer. A: Yes, sir, I believe that."); Yancey Test. at 1859:7-14 ("Q: What did you see? What did you observe Mr. Pendergraft doing? A: Mr. Pendergraft is very active and very engaged. He moves around the firm. I saw him talking to Mike Johnson. I talked to Phil about Mike Johnson. I talked to Phil at length about is -- is this living up to your expectations. Phil and I had discussions about had -- you know, had this -- again, had this -- the reality of this vision been fulfilling in the way that he anticipated.").

Prop. FOF 12. Mr. Pendergraft had the authority to promote Mr. Johnson and other Stock Loan Personnel.

- Exs. 526, 549, 664, 678, 711.

Prop. FOF 13. Mr. Pendergraft had the authority to hire and fire stock loan personnel.

- Exs. 666, 824.

Prop. FOF 14. Phil Pendergraft supervised Mike Johnson.

- Pendergraft Test. at 1521:5-11 (“Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question? A: Then I would say that I provided supervision to Mr. Johnson.”), 1513:5-7 (“ . . . in this time frame that Mr. Johnson reported to me, he would have largely taken his direction from me.”).

Prop. FOF 15. Penson’s Stock Loan Department and the Buy-Ins Department were separate departments, and a problem in one department did not suggest that there was an issue in the other department.

- Gover Test. at 173:7-9, 174:13-21 (“Just because there were issues in the buy-ins group of getting the executions done on time does not mean that there were issues in Stock Loan or were not issues in Stock Loan. They’re separate.”), 175:14-21 (“If you’re saying given the audit around the buy-in’s piece, no, I don’t think that that would have given rise to a reasonable inquiry of the Stock Loan.”); Delaney Test. at 1348:19-23, 1351:10-17 (“Q: . . . Mr. Alaniz’s audit tested the buy-ins department. . . . do you believe that an audit of a department that did not test whether there were failures to close out on long sales of loaned securities could ever be a red flag about failures to close out long sales of loaned securities in the Stock Loan Department? A: No. Q: . . . you did not see a nexus - - A: No”); *see also* Alaniz Test. at 855:11 – 856:12 (agreeing that, given the information he received from the various departments, it was not necessary to go to the Stock Loan Department or expand the test outside of buy-ins).

Prop. FOF 16. The registered representative supervisory matrices that reflected Bill Yancey as Michael Johnson’s supervisor were wrong.

- Miller Test. at 2601:25-2602:11 (“Q: Let me ask it this way. Do you think that the document is wrong when it lists Bill Yancey as the Pi org chart and the regulatory supervisor for Michael Johnson? A: In both columns, yes.”), 2603:1-6, 2623:14-19, 2594:13-21, 2595:19-25; Hasty Test. at 1794:12-1795:8 (“Q: In fact, it is an error that Bill Yancey is listed as Mike Johnson’s supervisor in any capacity? A: I would agree with that, yes. . . Q: Why do you believe that that is an error? A: I sat in the location where the Stock Loan folks were for a period of time. I mean, Mike Johnson is not a quiet person. He was

very vocal about who he reported to and where he got his directions and how, if something were to come up, who he was going to take his orders from. And so looking at all of these documents is all well and good, but at the end of the day, my own personal perception and observations of Mike Johnson and his own admission that he reported to Phil is what makes it clear to me.”); see also McCain Test. at 2190:6-2191:24 (identifying errors in the supervisory matrix); Yancey Test. at 1930:10-1932:22 (identifying errors in the supervisory matrix).

Prop. FOF 17. Kim Miller was directed to replace Phil Pendergraft’s name with Bill Yancey’s name for Michael Johnson’s supervisor in the Registered Representative Supervisory Matrix.

- Miller Test. at 2594:22-2595:11 (“Q: Do you recall at some point changing this matrix to put Bill’s name in as regulatory supervisor for Mike Johnson? A: Yes, sir. Q: Why did you do that? A: I was directed at some point to move people from underneath Phil onto Bill.”).

Prop. FOF 18. Employees at Penson understood Michael Johnson reported to and was supervised by Phil Pendergraft.

- Delaney Test. at 1217:3-10 (“Q: And who did Mike Johnson report to? A: Phil Pendergraft.”), 1336:10-13 (“Q: To your knowledge, Mr. Delaney, was there anyone in the Penson organization who was confused about who Mr. Johnson’s supervisor was? A: No.”); Hasty Test. at 1743:14-17 (“Q: From the time period that you started in August of 2008 through the end of 2011, who was Mike Johnson’s supervisor? A: Mike reported to Phil Pendergraft.”), 1745:13-16 (“Q: Are you aware of anyone at the Penson organization who was confused about who Mike Johnson was supervised by? A: No.”); McCain Test. at 2181:18-20 (“Q: You mentioned earlier -- or maybe I will just ask it again. Who was Mike Johnson’s supervisor? A: Phil Pendergraft.”), 2194:9-16 (“Q: In your mind, was there any confusion about who Mike Johnson reported to? A: Absolutely not. And Mike, everybody knew who Mike reported to. Everybody knew who everybody reported to, frankly. But there was never any question as to who Mike reported to. And if you didn’t—if you had any question, Mike would set you straight real fast”); Miller Test. at 2585:9-12 (“Q: If you had been asked by Mr. Warner in either of your prior two testimonies about who supervised Mike Johnson, what would you have told him? A: He reported to Phil Pendergraft.”); Gardner Test. at 1150:3-6 (“Q: And who was Mike Johnson’s supervisor during this entire -- during that entire period, August 2008 through November 2011? A: Phil Pendergraft.”), 1153:24-1154:2 (“Q: Ms. Gardner, are you aware of anyone in the company that was confused about who

supervised Mike Johnson? A: No.”); DeLaSierra Test. at 302:22-303:4 (“Q: . . . [G]iven your personal observations and the documents we’ve discussed, in our experience with supervisors, you would agree that Mr. Pendergraft was supervising Mr. Johnson? A: Yes. Q: Okay. And, indeed, that supervision extended to PFSI activities? A: Yes.”); Ex. 446 (July 30, 2014 Brady Letter) (“Brian Hall told the Division that Michael Johnson reported to Phil Pendergraft.”).

Prop. FOF 19. Tom Delaney, Bill Yancey, and Holly Hasty believed the November 2010 OCIE response, which stated: “Penson believes that the reasonable processes employed to close out positions that were allegedly in violation of rule 204T were effective and performed as designed” was accurate.

- Hasty Test. at 1738:25-1739:10 (“Q: Okay. And as you sit here today, Ms. Hasty, do you believe that Mr. Gover’s statement that ‘Penson’s processes and procedures were effective and performed as designed,’ do you believe that was truthful and accurate? A: Yes. Q: Do you have any reason to believe that Mr. Gover’s statement was inaccurate? A: No. Q: Misleading? A: No.”); Delaney Test. at 1365:13-21 (“Q: The sentence that reads, ‘Penson believes that the reasonable processes employed to close-out positions that were allegedly in violation of Rule 204T were effective and performed as designed;’ do you see that? A: I do. . . . Q: . . . Do you feel like that sentence was false? A: No. Q: Do you feel like that sentence was misleading? A: No. Q: Do you feel like that sentence was wrong, confusing or unclear? A: No.”); Yancey Test. at 1896:4-1897:23 (“Q: . . . It says: Penson believes that the reasonable processes employed to close out positions that were allegedly in violation of Rule 204T were effective and performed as designed. Do you see that? A: I see it. Q: And did you believe that to be correct at the time? A: Yes, ma’am. Q: Do you have any reason to doubt that statement? A: None.”); see Ex. 101.

Prop. FOF 20. Pendergraft selected Johnson as his direct report and consulted Yancey as to the change.

- Pendergraft Test. at 1512:10-1512:21 (“Q: . . . At any time, so just throw the date away for a moment, do you recall saying to Mr. Yancey that you wanted to put Mr. Johnson under you, that you wanted to take him and put him under you for a global purpose? A: Well, I’m sure that whenever Mr. Johnson -- whenever I picked up that as a direct report, whenever I picked up Mr. Johnson as direct report, I’m highly confident that I talked with Mr. Yancey about it. I don’t remember a specific conversation, but I’m sure that whenever that was that I did pick up that direct report, I’m sure there were conversations about that.”) (emphasis added), 1462:1-7 (“Q: Did you, from 2008 to 2011,

supervise Mr. Johnson in his supervision of PFSI's stock lending? A: Well, to the extent that Mr. Johnson provided—well, in certain ways, yes. The PFSI stock lending business rolled up to Mr. Johnson, and Mr. Johnson would have rolled up to me or to somebody else at the -- in the global organization.”).

Prop. FOF 21. Phil Pendergraft accepted supervision of Michael Johnson unconditionally.

- Yancey Test. at 948:9-17 (In describing Yancey's delegation to Mr. Pendergraft, Mr. Yancey stated: “And I said, so you become the supervisor for this whole area? And he said, yes, without any limitations. So I fully delegated it to him. He accepted that delegation.”), 1846:12-19 (“Q: But did Phil very clearly state to you that he would be Mike Johnson's supervisor? A: Yes, ma'am. Q: Did he in any way suggest he was taking on only part of a role or carving up that responsibility in any way? A: No, he didn't. And anything less than full delegation would not have been okay with me.”); Hasty Test. at 1746:913 (“Q: Did you ever believe that Mr. Pendergraft supervised Mr. Johnson from an operational perspective, and not from a regulatory or compliance perspective? A: No. I don't believe you can separate the two.”); Gardner Test. at 1152:7-15 (“Q: And did Phil Pendergraft supervise Mike Johnson's Stock Loan activities? A: Yes, he did. Q: Did he supervise Mike Johnson's PFSI Stock Loan activities? A: Yes. Q: Did he -- did Phil Pendergraft supervise Mike Johnson's non-PFSI Stock Loan activities? A: Yes.”); *see also* Delaney Test. at 1334:16-1336:13.

Prop. FOF 22. Employees at Penson observed Phil Pendergraft supervising and giving direction to Michael Johnson, including on issues related to PFSI stock lending.

- DeLaSierra Test. at 287:3-16 (“Q: His interactions were with Phil? A: Yes. Q: Okay. So when Mr. Johnson needed to discuss Stock Loan issues, he would discuss those issues with Mr. Pendergraft? A: Correct. Q: And those would include PFSI's Stock Lending issues? A: Yes. Q: When Mr. Pendergraft stopped by the PFSI Stock Loan department, you said his -- his communications were mostly with Mr. Johnson, right? A: Correct. Q: Would you see Mr. Pendergraft go inside Mr. Johnson's office? A: Yes.”), 302:22-303:4 (“Q: Mr. DeLaSierra, given your personal observations and the documents we've discussed, in our experience with supervisors, you would agree that Mr. Pendergraft was supervising Mr. Johnson? A: Yes. Q: Okay. And, indeed, that supervision extended to PFSI activities? A: Yes.”); Wetzig Test. at 417:6-13 (“Q: . . . Were you surprised to get an instruction from Mr. Johnson that was conveying an instruction from

Mr. Pendergraft? A: No, sir, not at all. Q: That was a fairly common occurrence, was it not? A: It was common, yes, sir.”); Hasty Test. at 1794:24-1795:8 (When asked why she thought the supervisory matrices were wrong she stated: “at the end of the day, my own personal perception and observations of Mike Johnson and his own admission that he reported to Phil is what makes it clear to me. . . .”); McCain Test. at 2195:8-16 (“A: . . . I would see him evidence of them communicating, whether it was in person, face to face, or whether it was through e-mail. In addition, my son worked on the Stock Loan Desk, and he would tell me, when I would see him after hours, that Phil came by the office to visit with Mike.”); Delaney Test. at 1217:5-10 (“Q: Were you able to observe any interactions between Mr. Johnson and Mr. Pendergraft? A: At times, yes. Q: Okay. And were they consistent with a supervisor/supervised relationship? A: From my perspective, yes.”); Gardner Test. at 1153:13-21 (“Q: What are some tasks that supervisors performed at Penson? A: Performance management, compensation management, business strategy. Q: And any others that you can think of? A: Reprimanding, that type of thing. Q: Did you see Phil Pendergraft performing those types of tasks with Mike Johnson? A: Yes.”).

Prop. FOF 23. Bill Yancey conducted weekly group and one-on-one meetings with his direct reports.

- Delaney Test. at 1339:1-19 (“Q: Did he meet with you regularly? . . . A: As part of a rigor, at least a couple times a week, but in many cases more than that . . . Q: Did Mr. Yancey have a routine group meeting of all his direct reports? A: He did.”); Yancey Test. at 1840:9-25 (“Q: What was your approach in terms of supervising the people who were your direct reports . . . A: I set up a one-on-one with them, and then I held a regular Tuesday morning at 9:00 a.m. staff meeting for my direct reports every week.”); McCain Test. at 2178:14-25 (“A: . . . He held a weekly management meeting that included all of his direct reports”).

Prop. FOF 24. A representative from the Stock Loan department attended the March 31, 2010 Rule 3012 meeting.

- Johnson Test. at 539:20-22 (“Q: Okay. Was it your understanding that someone from your team attended or may have attended the meeting? A: Yes.”); Ex. 224 at 351:13 (“I recall either Rudy or Brian being there.”).

Prop. FOF 25. PFSI's Compliance department did not believe that the December 2009 Audit warranted explicit reference in the CEO Certification Summary Report.

- Delaney Test. at 677:22-24 ("Q: And you would have expected it to be in the Summary Report; isn't that correct? A: No."), 1360:25-1361:10 ("Q: And the December audit, which we've seen was -- you believe was the focus of prompt remediation, was not explicitly listed as an item in that Summary Report; do you agree with that? A: I do. Q: Why was it not specifically identified? A: The testing results from Eric that had come, that had been reported out, had already been substantially starting to be remediated at that point, and it was inclusive in the material that was there with the report."); Alaniz Test. at 826:13-21 ("Q: And in filling out this form, do you recall if you put those 3012 test results in? A: No. . . . Q: Okay. I suppose you could have if you thought they were -- if you considered them to be that important, right? A: Yes."), 858:7 – 858:23 ("Q: If you had wanted that to be included, would you have suggested that to Mr. Delaney? A: I believe we definitely would have had a discussion about it. I don't see why. . . it would have been an issue with him. . . . Q: So if you had thought it was an important issue and should have been included, you had the ability to tell him to include it? A: Yes.").

Prop. FOF 26. Files containing all 3012 testing results, including the December 2009 Audit results, were made available to regulators for their review.

- Delaney Test. at 1303:24-1305:7 ("Q: Could you read just that whole section for us. A: 'The PFSI testing plan consists of three components that were executed throughout the certification year. Those components are: Identification, scope and prioritization of issues and areas to be tested (attached); execution and documentation of testing (available in the Compliance Department); exception and remediation tracking (attached).'"); Alaniz Test. at 804:12-805:3 (discussing 3012 test results, "Q: I mean, did you -- did you shred them as soon as you were done? A: No, I would put all my documentation in folders and keep them there. Q: And why -- why is it that you'd keep them there? A: Well, they were able to be reviewed by the regulators, FINRA specifically. Q: Okay. So FINRA can come in and ask for it and you -
- A: Exactly. Q: Did that ever happen when you were at Penson? A: Yes."); Ex. 135 (stating that 3012 test results were "available in the Compliance Department").

Prop. FOF 27. The information in the Registered Representative Supervisory Matrix did not reflect the actual or day-to-day supervisory responsibilities.

- Poppalardo Test. at 2041:2-6 (“Q: If a supervisory matrix is given to FINRA or CBOE designating, as these do, of regulatory supervisors, what does that say about who has day-to-day responsibility for supervision? A: It doesn’t say anything.”); *see also* Hasty Test. at 1795:13-18 (“Q: Does the fact that an erroneous document was given to the regulators in any way change what the supervisory chain with Mike Johnson was in reality?” . . . “A: No.”).

Prop. FOF 28. Michael Johnson had one supervisor; he did not have a dual-reporting supervisory structure.

- Gardner Test. at 1151:12-19 (“Q: During this time period that we have been talking about, after August 2008, did – did Mike Johnson have a dual reporting – dual reporting to anybody? A: No. Q: He only – he had one supervisor? A: Yes. Q: And who was that supervisor? A: Phil Pendergraft.”); *see also* Hasty Test. at 1745:5-7 (Q: Is there any chance that Mr. Johnson had two supervisors? A: No.”); Johnson Test. at 537:25-538:3 (“Q: And during that period of time, did you only have one supervisor, and was that either Mr. Phil Pendergraft or Mr. Dan Son? A: Yes.”).

Prop. FOF 29. Supervision must include regulatory compliance.

- Poppalardo Test. at 1999:8-24 (“A: . . . I feel really strongly that - - that you just can’t parse the business activities from the regulatory requirements. . . . A: I’ve never seen it.”); *see also* Hasty Test. at 1746:9-13 (“Q: Did you ever believe that Mr. Pendergraft supervised Mr. Johnson from an operational perspective, and not from a regulatory perspective? A: No. I don’t believe you can separate the two.”); McCain Test. at 2203:10-17 (Q: . . . do you think an employee can have more than one supervisor? A: . . . I think it’s impractical. No, I don’t - - it doesn’t work.”).

Prop. FOF 30. Employees at Penson believed that Bill Yancey was an accessible and engaged supervisor.

- Delaney Test. at 1339:23-1340:1 (“Q: Was Mr. Yancey an accessible supervisor? A: He was. Q: Was he an engaged supervisor? A: He was.”); *see also* Hasty Test. at 1701:25-1702:8 (“he was always present at different meetings that we would have, and he was always very engaged”); Wetzig Test. at 423:16-424:3 (“Q: Was he engaged? A: Yes, sir, he was.”); McCain Test. at 2178:5-7 (“Bill was a - - a very involved manager.”); Alaniz Test. at 837:8-18 (“Q: Was Mr. Yancey

engaged during the course of those [3012] meetings? A: Yes. Q: Was he attentive? A: Yes. Q: And he showed interest in what you were doing? A: Yes. Q: Did he ask some questions? A: Yes.”); Gover Test. at 176:18-177:9 (“Q: Did -- did you believe Bill Yancey was a man of good morals? A: Yes. Q: Did you believe that Bill Yancey was a do-the-right-thing kind of person? A: Yes. Q: Did you have an open relationship with Mr. Yancey? A: We were open and candid with each other when we disagreed. I would say the extent of our interaction was at work, but yes. Q: And do you believe that Mr. Yancey had high ethical standards? A: Yes. Q: Do you believe Bill Yancey advocated good corporate citizenship? A: Yes.”).

Prop. FOF 31. Eric Alaniz, and the Compliance Department, decided who to invite to the March 31, 2010 Rule 3012 Meeting.

- Alaniz Test. at 714:10-714:17 (discussing the 3012 meeting, “I typically test around 20 items, on average, a year. So what we discussed were the items that -- particularly that had -- that were of interest to the parties involved here, that had issues that we know -- we knew that possibly could generate questions from the CEO. So we invited them to be there to be able to respond accordingly.”) (emphasis added); Yancey Test. at 1882:8-1882:11 (“Q: Okay. Well, now, you said it wasn't your invitation. But did you give direction about who should be invited to attend? A: No, ma'am.”); Exs. 674, 99.

Prop. FOF 32. Bill Yancey received a separate calendar invitation to the March 31, 2010 Rule 3012 Meeting that did not include the other invitees.

- *Compare* Ex. 633 (invite to Mr. Yancey) *with* Ex. 674 (invite to other invitees); Alaniz Test. at 851:2-4 (“Q: So [Yancey’s] invitation didn’t necessarily show who else had been invited to the meeting; is that right?” A: Correct.”).

Prop. FOF 33. Eric Alaniz prepared the initial draft of the 3012 Summary Report attached to the March 31, 2010 CEO Certification.

- Alaniz Test. at 856:22-852:2 (“Q: Okay. You prepared the initial draft of that, right? A: Of that, yes. Q: Yes. Using the template, as you mentioned? A: Correct.”).

Prop. FOF 34. Penson subscribed to a training package from FINRA that allowed its personnel access to all available FINRA training series or webinars.

- Hasty Test. at 1711:17-1712:6 (discussing FINRA training programs, “A: Penson subscribed to the complete training, the all you can eat package, if you will.”).

Prop. FOF 35. Bill Yancey and Tom Delaney worked together to develop Penson's quarterly 3012 testing regime and meetings.

- Yancey Test. at 882:23-883:11 ("A: I wanted there to be vibrant testing more than once a year. And so I worked with my CCO to develop a good routine for testing and then meet on a quarterly basis to make sure that we had the opportunity to detect things that might not be going as well as we'd like and have the opportunity to remediate them so that, in the certification, we would be confident about the test and the results.").

Prop. FOF 36. Bill Yancey approved many compliance measures, including expanding the compliance staff and implementing a compliance system called Actimize, which cost nearly \$500,000.

- Delaney Test. at 1340:17-1340:24 ("When I started with the Compliance department, it was about a team of five or so, and at our high point we had over 25 compliance associates that were in that department. It was a meaningful -- it was a meaningful addition to -- to staff. We had implemented a very, very expensive compliance system called Actimize, the implementation of which I recall was nearly \$500,000. Bill Yancey approved that without blinking an eye."); Alaniz Test. at 840:21-23 (discussing increased staffing in the Compliance Department, "Q: And did Bill Yancey fully support that increase to the Compliance department? A: Everything I heard, the answer would be yes.").

Prop. FOF 37. The November 24, 2010 OCIE response was drafted by Mr. Gover, and reviewed by Ms. Hasty and Mr. Delaney.

- Delaney Test. at 1368:8-19 ("Q: This letter was reviewed and drafted by Mr. Gover, fair? A: Fair. Q: By you? A: Fair. Q: And by Ms. Hasty? A: Yes, sir. Q: Your deputy Chief Compliance Officer? A: Yes, sir. Q: So three levels of review before Mr. Yancey sees the letter; fair? A: That's fair."); Exs. 86, 208.

Prop. FOF 38. Delaney believed that there was no reason for Bill Yancey to question the truthfulness or accuracy of Penson's 2010 OCIE response.

- Delaney Test. at 1368:20-24 ("Q: Can you think of any reason whatsoever why Mr. Yancey should not have been entitled to rely on the judgment of you, Ms. Hasty as Mr. Gover as to the truth of that statement? A: No.").

Prop. FOF 39. Bill Yancey had no reason to overrule the judgment of the compliance department regarding the contents of the 3012 Summary Report attached to the 3130 CEO Certification.

- Delaney Test. at 1362:22-1363:1 (discussing the 3012 Summary Report, “Q: Do you know of any reason whatsoever that Mr. Yancey should have overruled the judgment of the Compliance department about what should go in that report? A: No.”); Ex. 828 p. 18 (Poppalardo Report) (“Mr. Yancey, like most CEOs in the industry, relied on the report prepared by his CCO, and I believe his reliance was reasonable . . . The 3012 process would quickly become unwieldy if firms included all regulatory and internal testing findings in their 3012 reports.”); Poppalardo Test. at 1998:3-1998:24 (“I’ve not seen any CEOs, you know, that go much beyond just receiving the report. They get comfortable enough with the areas that have been tested and the results as they’ve been represented to them, and they execute a certification.”); Yancey Test. at 1887:22-1888:13 (“Q: Did you have any reason to disagree with Mr. Delaney’s inclusion or exclusion of material on his Summary Report? A: No, ma’am.”).

Prop. FOF 40. Pension was not required to explicitly reference the December 2009 Rule 204 Audit in the 3012 Summary Report attached to the CEO certification.

- Delaney Test at 1360:25-1361:10 (“Q: And the December audit, which we’ve seen was -- you believe was the focus of prompt remediation, was not explicitly listed as an item in that Summary Report; do you agree with that? A: I do. Q: Why was it not specifically identified? A: The testing results from Eric that had come, that had been reported out, had already been substantially starting to be remediated at that point, and it was inclusive in the material that was there with the report.”); see also Poppalardo Test. at 1959:24 – 1960:7 (“But we don’t see. . . every exception that’s been identified in an examination report or an internal testing, because there’s just too many. The report wouldn’t be useful anymore if you put all of these test results in there. There’s got to be some judgment, and you have to – and it’s really the Chief Compliance Officer who determines what it material enough to – to be in the report.”); Poppalardo Report Ex. 828 p. 18 (“I do not believe there was an omission in the 3012 Summary Report regarding the results of the December 2009 Rule 3012 audit.”), (“Mr. Yancey, like most CEOs in the industry, relied on the report prepared by his CCO, and I believe his reliance was reasonable . . . The 3012 process would quickly become unwieldy if firms included all regulatory and internal testing findings in their 3012 reports.”).

Prop. FOF 41. Penson tracked and assigned to the appropriate business units remediation of all deficiencies from internal and external audits.

- Ex. 135 at 6 (“All deficiencies from internal and external audits are tracked and assigned to the appropriate business unit for remediation.”).

Prop. FOF 42. Penson consistently closed out or cleared the overwhelming majority of its CNS fail positions.

- Gover Test. at 166:8-12 (Q: In fact, I think you testified earlier that, doing it the other way around, 99 percent of the trades would have settled normally by T+3; is that fair? A: I think what I had said was that 99 percent plus of all DTC trades settle on time.”), 167:11-20 (“Q: If it's T+4, morning of T+4 before market open, what percentage of the T+4 fails to deliver do you think Stock Loan was able to borrow to cover for? A: It was -- it was a high percent. We did not have to send very many orders to the execution desk to be bought in. Q: . . . Do you think higher than 80 percent? A: Yes.”); Wetzig Test. at 387:2-388:4 (“Q: Well, did you -- did the borrowing counterparties return shares pursuant to a recall by T+6? A: They did, in many cases, yes. . . . Q: And then do you -- when you received the shares back from the borrowing counterparty, would that clean up your CNS position immediately on T+6? A: If there wasn't a deficit in front of the CNS obligation, the shares would come directly to the CNS obligation. Q . . . it would actually clean up the CNS position more quickly than a buy-in on T+6 would, correct? A: That is correct. Q: And when would a buy-in from a T+6 . . . clear up the CNS position? A: If you bought in on T+6, the trade would not settle until T+9. Q: So you could have a persistent fail, the failure to deliver on that right up until T+9, potentially? A: That is correct. Q: Even though you complied with the rule, even if you bought at market open? A: That is correct.”), 389:3-10 (“Q: Do you know -- do you have any idea of the rate at which you closed these out? A: That we closed them out or that they -- Q: That the CNS position cleared up. I apologize. A: I would say that -- 98 percent. Q: 98 percent. Would you be surprised if it was actually higher? A: I would not.”).

Prop. FOF 43. Mr. Paulukaitis's written expert report does not mention dual supervision.

- Paulukaitis Test. at 477:2-4 (“Q: Is there anything in your report that covers the concept of dual supervision? A: That specific concept, I don't believe so. No.”).

Prop. FOF 44. Michael Johnson did not refuse to attend the March 31, 2010 meeting regarding the December 2009 audit.

- Johnson Test. at 538:25-539:12 (“Q: Did you ever refuse to attend a March 31, 2010 CEO certification meeting with Mr. Yancey? A: I don't think so. Q: Did you, in fact, tell Mr. Yancey early on that it was difficult for you to attend meetings that occurred during the hours that the securities markets were open? A: I think I told all executives that. Q: And is it true that as a general rule, you did not attend business meetings during the course of the market trading day, but that you were always available to meet either before the markets opened or after the markets closed? A: Yes.”); *see also* Ex. 674 (calendar appointment for the March 31, 2010 meeting stating, “If for some reason you can't attend please have a representative show up in place of you to discuss the 3012 Test conducted in your respective areas.”).

Prop. FOF 45. When Bill Yancey asked if Michael Johnson was needed to discuss the December 2009 Audit, he was told that Michael Johnson was not necessary because it was a Buy-Ins issue.

- Alaniz Test. at 762:23-763:7 (“Q: And what was the response? A: Mr. Yancey's response was that we should bring in Michael Johnson to the conversation. Q: And was there any response to that? A: I had a response. Q: What did you say? A: I had told him that I didn't believe that was necessary. All indications from the security lending department and the buy-ins department was that they were cooperative in remediating those issues.”); Delaney Test. at 613:13-19 (“And when Mr. Yancey -- when we reported out the issuing and Mr. Yancey's first reaction was, do I need to get Mike Johnson down here, I believe it was Eric that said, this is a buy-ins issue, and we have this -- we have - - and we're -- and we're dealing with the buy-ins department on it. If we need to get those folks in, we can get them in later.”), 1354:4-12 (“A: I recall that he specifically asked if we needed Mike Johnson to attend the meeting. Q: And what was Mr. Yancey told? A: Mr. Yancey was told that this was a buy-ins problem and that -- and that we had been -- the compliance group was working with the buy-ins department to remediate the issue. Q: Who told him that? A: Eric Alaniz.”); Ex. 224 at 329:16-330:2 (“And Mr. Alaniz and myself were in a -- were in the office with Mr. Yancey briefing him on the specific findings. He, at that point, had made mention of the fact that well, this was something we need to get Mike Johnson in the office for. . . . We, at that point in time, had explained that we didn't think at this point that there was a stock loan issue, that this was really appearing to be a buy-in issue. And we were working with buy-in folks, which don't report in to Mike Johnson but that -- and that we would continue to test this issue going forward.”); *see also* Yancey Test. at 1878:6 – 1879:15

(testifying that he inquired as to whether Johnson should be present for additional guidance).

Prop. FOF 46. In Penson's 3012 testing and 3130 certification meetings, Yancey was generally provided with a high-level summary.

- Alaniz Test. at 836:21-837:1 ("Q: In the meetings with Mr. Yancey, did you go through all of the material in those folders or boxes with him? A: We did not pull out the binder itself and go page to page, but we gave him a higher level of result of the testing at the time.").

Prop. FOF 47. Penson's 3012 testing and remediation plans were a collaborative process, which required Eric Alaniz to rely on the business units as the "subject matter experts" or "specialists" in each department.

- Alaniz Test. at 726:3-6 ("Q: And do you do that kind of in isolation or is it a collaborative process with -- with the business units? A: It's collaborative."), 726:15-17 ("Q: And do you rely on those business units for information about what is going on at the firm? A: Yes."), 784:25-785:4 ("Q: Was it typical of your experience in -- as a Compliance Officer that you would identify problems and the business units would come up with the most efficient solutions to -- to solve those problems? A: It was typical, yes."), 846:14-17 ("Q: And did Mr. Yancey understand the 3012 testing to involve a collaborative process between Compliance and the departments to get those remediation plans in place? A: Yes.").

Prop. FOF 48. In its 3012 testing process, Penson's compliance department identified regulatory issues and/or problems, and the business units provided solutions.

- Alaniz Test. at 784:25-785:4 ("Q: Was it typical of your experience in -- as a Compliance Officer that you would identify problems and the business units would come up with the most efficient solutions to -- to solve those problems? A: It was typical, yes."); 794:20-25 ("A: . . . The reason we brought these business owners into this meeting. . . after going through all the items, he [Yancey] would have questions that only the business owners could answer."); 846:14-17 ("Q: And did Mr. Yancey understand the 3012 testing to involve a collaborative process between Compliance and the departments to get those remediation plans in place? A: Yes.").

Prop. FOF 49. The 3012 topics/items selected for testing did not necessarily reflect potential regulatory issues.

- Alaniz Test. at 734:24-735:10 (“Q: Okay. So a good swath of the concerns that FINRA would talk about, you would just set those aside? A: Right. Q: I’m sorry. I just wanted to make sure that was clear. So then you would come up with a list of, you say, four or five? A: I would say four or five. With that rule, you must test certain items every year. And on top of that, I would add a few that we would see out there. And then from there, I would take that list to Tom Delaney, and we would review to see what to add, remove.”).

Prop. FOF 50. Penson’s implementation process for new rules and regulations was as follows: In response to a new rule, the Compliance Department held initial meetings with the affected business units and management to determine what procedural changes, development efforts, technology resources, or training is required, as well as to create a roadmap for compliance deadlines and testing. Penson also distributed special compliance memorandums both internally and externally to keep employees and correspondents abreast of the recent regulations. A similar process was used with the implementation of Reg SHO and Rule 204T/Rule 204.

- Delaney Test. at 1249:21-1250:8 (“Q: Okay. You’ve just described or we’ve gone through a number of things that happened when Rule 204T was passed, including meetings and these memos. Anything else you recall that you did there at Penson -- and by ‘you,’ I guess I mean the whole company -- to alert employees and -- and others about the changes in the rule? A: I mean, I just know there -- there were -- there were lots of communications that were happening to alert -- to alert employees within the company and to the extent it was germane to our correspondents outside. We were dealing with both outside and inside counsel. This was a -- this was a big effort.”), 1250:20-25 (“Q: Did you go through anything like the same process? A: Still would go through the same process, still reached out to counsel, still gathered and looked at all of the information that was out there, synthesized communications and put those communications out, sure.”); Hasty Test. at 1707:11-1708:24 (“Q: Ms. Hasty, what -- if you recall, can you discuss the steps that Penson’s Compliance Department took when new rules and regulations were issued or changed? A: So typically new rules and regulations would come to us in a variety of different ways. Many of us were signed up for different types of alerts that came from the regulators themselves. Most of the SROs have the ability for you to sign up for a news feed or something along that line. And there are lots of different publications that come out on a regular basis that provide that information. So it was pretty well circulated.

Once we received something and we had a chance to review it, oftentimes we would set off – set up meetings with the different business owners that we felt like these particular rule changes or new rules would touch, and we would start working through the process of determining what procedures may need to be changed, what development effort, you know, the technology resources or people resources might be required, and -- and really try to lay out the road map for how we were going to meet certain compliance deadlines and making sure that we would be compliant at the time those rules came into effect. It wasn't uncommon for us to use working groups or put together, you know, groups of folks who met regularly that covered a lot of different business areas, just to make sure that everybody understood and was onboard with how we were going to implement a new rule or regulation.”), 1715:2-14 (“A: . . . So if there was a new rule that might come out and we knew that we had a six-month implementation date we, would get a group of both dedicated business owners, oftentimes we would have a legal representative, there would be someone from compliance, there would be folks from technology, to really work through what updates the procedures needed to be made, what development or IT resources would be needed, what reports might need to be created, whether there was staffing that needed to be addressed, if there were forms or notifications to any of our documents that needed to be made. All of those things were things that we worked through in these working group.”), 1718:13-18 (“Q: Okay. What did Penson do to ensure compliance with Rule 204? A: I know the firm updated its procedures. There was technology efforts to create new reports and new information that was being used to comply with the particular rules.”), 1719:16-24 (“Q: This is a Special Compliance Memorandum dated September 22nd, 2008. I guess my first question is: What is a Special Compliance Memorandum? A: These would typically be information that the Compliance Department would put together to distribute both internally to our employees and to our staff and also to our correspondents as well -- and our customers to make sure that they understood and were aware of changes that Penson was going to make.”).

Prop. FOF 51. Brian Hall told the Division that Michael Johnson reported to Phil Pendergraft.

- Ex. 446 (July 30, 2014 Brady Letter).

Prop. FOF 52. Penson provided compliance training to its employees, including training on Regulation SHO and Rule 204.

- Hasty Test. at 1710:6-1711:16 (“Q: I want to ask a little bit about training. What training, if anything, did Penson offer on new rules and

regulations? How did that work? A: Well, we would typically -- we had -- we would create a training program annually, and that training program consisted of a number of different variables. Some of them were required by regulation and others were additional training that we made available to our employees so that -- to help them better understand their roles and to better understand the rules and regulations. We conducted an annual compliance meeting every year that touched on a lot of different just high-level security regulations. Every single business unit was given one or two different targeted training modules that they had to complete. So, for example, somebody in trading, as an example, might get a module on insider trading, or a module on market making, or something along that nature that was specific to the type of role that they were engaged in. And then beyond that, Penson subscribed to FINRA's webinar series. We took all of the training that was provided by FINRA, and we would make those available to different groups. So it was not uncommon for us to host different training seminars where that we would target certain folks within the firm, invite them to come and review those webinars and see those webinars. And the firm also conducted luncheon learns that anyone could attend. And throughout the year, there were all different types of the business units, including compliance, that put on programs that anyone in the firm could attend, bring their lunch, and get an overview of the different areas of the firm and ask any questions that they had. So training was pretty consistent and it was always present throughout what they were doing.”), Ex. 384 (discussing giving access to a Reg SHO webinar for Penson employees); Hasty Test. at 1740:12-14 (“A: . . . we had taken several webinars for Reg SHO and made those available.”); 1741:24-1742:2 (discussing Exhibit 384 “Q: Is this consistent with your general recollection of the types of training that was offered at Penson? A: Yes.”).

Prop. FOF 53. Penson regularly updated its Written Supervisory Procedures (WSPs) through a collaborative process across the various departments, as well as maintained other localized checklists.

- Hasty Test. at 1712:19-1713:11 (“Q: And when you were at Penson, did you understand that the WSPs was to be updated? A: Yes, they were updated regularly. Q: And if you can, what -- at a high level, how did that process work? A: Typically, it could happen a couple of different ways. One could be there could be a change or a modification to a rule or a regulation that would require us to make a targeted change to the WSPs. It could also be as a result of an annual review or a regular review of the WSPs, where the WSPs are sent out to the various business owners in all of the different areas that those WSPs that attach to each business unit are sent to the managers of

those units for them to review, to let us know if there's anything that needs to be updated or anything that's changed in their day-to-day work that we need to address in those procedures.”), 1713:17-1714:16 (“Q: Now, you mentioned, I think you called it maybe a desk book or something. Were there other written materials that Penson's business units relied on? A: Some of the various business units did have desktop procedures or other types of guides that they used to help them with their day-to-day activities. For example, our onboarding group put out a document called The Guide to Penson. It was something that they used not only as a checklist to help them onboard new customers, but it was also a document that they would give to customers to help them introduce them to Penson and where to go and who to contact for different things. So there were different types of documents that existed within the firm that were not part of the written supervisory procedures. Q: And so how -- what is the function of those procedures as compared to the WSPs? A: Typically, those are more user level-type manuals. They're defined to specifically instruct somebody what they should do in a particular situation. They're designed to be step-by-step guides to how you would conduct your work or your business or how you might answer a question that you might have, and not designed necessarily to provide a high-level overview.”); Wetzig Test. at 393:16-23 (“Q: What about Stock Loan; did Stock Loan have a set of desk procedures? A: We essentially had a checklist of items that we needed to do every day to get our job done. . . you could refer to them as desk procedures, I would say.”).

Prop. FOF 54. Rule 204 contains a “safety valve” in the form of the penalty box because no system can guarantee perfect settlement. The penalty box allows the capital markets to continue operations related to short selling.

- Paz Test. at 2061:14-2063:5 (“Q: Mr. Paz, can you describe the penalty box requirement pertaining to Rule 204? A: Sure. The penalty box requirement is another one of those ideas that had been around for a long time since Reg SHO or perhaps even before. But I see it as a safety valve, and those are -- those are my words. I don't think you will find it in any Commission release. But I see it as a safety valve for the following reasons: The Commission understands that, and as stated in public releases, that fails to deliver will occur. They will happen. I would venture to guess that there are some happening today. The Commission also understands that there will be failures to settle, to close out. Those occur as well. The penalty box says any system will be --cannot guarantee 100 percent delivery or 100 percent settlement at the time of settlement. What if the safety valve to allow the market to continue to operate, and that's where the penalty box comes in. It says if you pre-borrow, you may continue to affect

short sales. I'm simplifying the rule quite a bit. There's a lot of complexity in that rule. But in essence, it continues to allow the operations of the capital markets in short selling in circumstances that require more of the registrant, in this case, a pre-borrowing requirement, which I'm losing the paraphrase, but it's not just pre-borrowing, but also entering into bona fide contracts to borrowing and agents to borrow. At one point under predecessor rules under Reg SHO there was comments solicited, I believe, and then there was certainly discussion of this pre-borrow requirement being the norm as opposed to a close-out requirement. And as you can see during the financial crisis, the close-out requirement is what the Commission went with in an emergency manner. That was renewed and evenly adopted in a final stage. But it did -- it did maintain this safety valve, which is the aspect of the rule you refer to. Q: Why do you need a safety valve? A: Because you will not have perfect settlement.”).

Prop. FOF 55. “Penson Financial,” “Penson,” or “PFSI” refers to the U.S. broker-dealer, a subsidiary of Penson Worldwide (“PWI”).

- Hasty Test. at 1697:2-5 (“Q: If I use the term ‘Penson Financial’ or ‘Penson’ or ‘PFSI,’ do you understand that to mean the broker-dealer, the U.S. broker-dealer? A: Yes.”).

Prop. FOF 56. The relevant time period at issue in this case for alleged violations of Rule 204(a) relating to long sales of loaned securities is October 2008 through November 2011; however, with respect to Mr. Delaney’s alleged aiding and abetting violations of Rule 204(a) the time period is October 1st, 2008 until approximately February 15th, 2011.

- OIP ¶ 10; Stip. FOF 7, 58.

Prop. FOF 57. “Stock Lending,” “Stock Loan,” or “Securities Lending” refers to Penson’s Stock Loan Department.

- DeLaSierra Test. at 203:15-204:9, 204:21-205:8 (“Q: So if we’re saying *Securities Lending* or *Stock Loan*, interchangeable? A: Yes, correct. . . . Q: So you did all the functions in *Stock Lending*? A: Yes. . . . Q: Mr. De La Sierra, I want to talk for a moment about the mechanics of the *Stock Lending department* or the *Stock Loan department* at Penson. What did *Stock Loan* do at Penson Financial Services? A: We were -- we lent the box.”) (emphasis added).

Prop. FOF 58. Bill Yancey was not aware that the Registered Representative Supervisory Matrix was sent to regulators.

- Yancey Test. at 966:21-25 (“Q: Okay. Mr. Yancey, were you aware that Supervisory Matrices Regulatory -- excuse me -- Registered Representative Supervisory Matrices were sent to regulators? A: No.”).

Prop. FOF 59. It was not uncommon for Phil Pendergraft to be invited to meetings with regulators.

- Hasty Test. at 1729:11-21 (“Q: Okay. You said you might assemble a meeting. Who would typically attend a meeting regarding an exam? A: So typically we would invite all of the senior managers, so Bill, as an example; Tom would be invited. It was not uncommon for Bill to be invited to those, Phil Pendergraft to be invited. We would also include legal, in-house legal counsel, any of the business managers or business units, if they had an immediate supervisor, those -- those would be included. So we would typically have a pretty large audience when we were talking about, you know, a regular exam.”); Yancey Test. at 1840:6-8 (“Q: And was Phil Pendergraft in those kickoff meetings? A: As often as possible, as I recall.”).

Prop. FOF 60. Delaney was a conscientious, qualified, and engaged CCO.

- Prop. FOF 1 (Delaney holds Series 4, 7, 24, 27, 53, and 63 licenses); Alaniz Test. at 724:24-725:2 (“[Delaney] knew a lot about the industry. I felt I could learn from him. He just had a lot of the answers. I mean, he knew the industry very well. I could ask him a question and he would know.”); Hasty Test. at 1762:7-12 (“Q: . . . Was that typical of Mr. Delaney, to ask you your opinion? A: Sure. We collaborated on a lot of things. Q: And did you feel like when you gave him your opinion, that he was responsive to that? A: Yeah, absolutely.”), 1767:3-10 (“We had a good working relationship. We collaborated on a lot of projects. We worked on a lot of different initiatives to try to make the Compliance Department better. And it was a very good working relationship.”); McCain Test. at 2200:8-17 (“Very open, very engaging, very willing to get the material and documents that [regulators] requested.”); Yancey Test. at 1907:25-1908:24 (“Q: And why is that? What about Mr. Delaney made you recommend him? A: I’m a real people person. We had a real hardy discussion. I asked him all the questions that I felt were entirely appropriate. I probed him. To the best of my ability, I tested his knowledge. We talked about his resume and his background. I asked him what his vision was to make sure that we aligned in regard to how we saw the role in the future. And so at the end of that robust

discussion I had with Tom, I felt strongly that Tom was an excellence candidate. . . . A: Tom and I had an excellent relationship. Tom came to his meetings like I wish everybody did, and most people do. He had a list. He had data. He had facts. He had observations. He probed me. I probed him. That's how we worked together.”); *see also Delaney Test. at 1203:9-15* (Delaney had over a decade of experience in the industry before joining Penson), *1237:10-22* (“Q: And as Chief Compliance Officer, did you have any meetings with people you supervised? A: Sure . . . Q: And what -- who ran those meetings? A: I would run those meetings. Q: Do you recall what you would do there at those meetings? A: Inform my team and staff and what -- and what we were doing. To the extent I would need to delegate to folks certain rules and responsibilities, I would do that in those meetings.”); *Pendergraft Test. at 1582:25-1583:12* (“Q: Did you feel like Mr. Delaney was the best qualified candidate for that job that you found? A: Well, he was certainly the best qualified candidate that we interviewed. I mean, I recall Mr. Delaney being our first choice for the job. So he was certainly -- I think we felt like he was qualified and he was the best candidate that we had seen. Q: And that attitude that you talked about, about it being more important to do what's right than to make money, do you feel like he shared that attitude, in your observation during his time there at Penson? A: Yes, sir.”), *1585:21-25* (“Q: And tell me, if you will, what was your opinion? Do you feel like compliance at PFSI or at Penson generally got better during Mr. Delaney's tenure as CCO of PFSI? A: Absolutely.”), *1588:1-4* (“A: . . . I did not have, nor do I believe that Mr. Yancey or anyone else in our management team, had any concerns with Mr. Delaney's giving advice or management of compliance functions.”).

Prop. FOF 61. Delaney was unaware of Rule 204 issues related to the Stock Loan Department until early 2011.

- *Delaney Test. at 699:24-700:18* (“Q: When did you first find out that Stock Loan had a role in closing out long sales? A: . . . it would have been no earlier than that February or that March 2011 letter.”).

Prop. FOF 62. Delaney considered Yancey as more than just a manager or supervisor; Delaney considered Yancey a mentor and friend to the Compliance Department.

- *Delaney Test. at 1328:13-17* (“A: Mr. Yancey is -- Mr. Yancey exhibits a -- Mr. Yancey is a -- he exhibits a lot of integrity. He's an honest man. He's been a mentor. He was always a friend of the Compliance department, and I'm -- I am proud to know Mr. Yancey.”), *1369:7-14* (“A: What did you mean earlier when you said Mr. Yancey was a mentor? A: Mr. Yancey is more than just a manager or a

supervisor. He -- he -- he provokes meaningful thought leadership and really presses me and had pressed me throughout my time at Penson to be a better -- to be a better manager, to be a better leader, to be a better contributor to the organization.”).

Prop. FOF 63. Delaney was honest, transparent, and full of integrity.

- See Alaniz Test. at 831:10 (“I believe [Mr. Delaney] is an honest guy”); Pendergraft Test. at 1588:5-14 (“Q: Do you feel like you, over the years that you worked with him, got to know Mr. Delaney and to the point where you can feel like you have an opinion about his character? A: I believe that I -- I believe that I did work closely enough with him to form a view of his character. And I believe Tom Delaney is a fine man who is dedicated to doing the right thing. Q: Do you believe he's honest? A: Yes, sir.”); Hasty Test. at 1757:23-1758:1 (“Q: -- you reported to [Mr. Delaney] Did you ever see him -- and the "him" here is Tom Delaney. Did you ever see him accept anyone deliberately violating any rule? A: No.”), 1766:1-1767:17 (“ Q: In your experience with Mr. Delaney and your time together at Penson, did you see Mr. Delaney make any -- take any actions motivated by financial consideration? A: No. Q: Did you ever see Mr. Delaney conceal any violations from regulators? A: No. Q: Did you ever see the opposite, that is disclosing problems to regulators? A: Absolutely. We had a regular history of being very transparent with the regulators. Q: Did you ever know Tom Delaney to authorize WSPs that he knew concealed the actual procedures of any business unit? A: No. Q: Did you ever know Tom Delaney to conceal anything from Mr. Yancey? A: Not to my knowledge. Q: Let me ask you: You worked with Mr. Delaney for two and a half years, give or take? A: Probably about three years, two and a half, yeah. Q: And during that time do you feel like you got to know him well enough to have an opinion of his character? A: Yes. Q: And what is your opinion of his character? A: Tom is a very nice man. I enjoyed working with him. I never had any reason to believe that he wasn't forthright with me or honest. We had a good working relationship. We collaborated on a lot of projects. We worked on a lot of different initiatives to try to make the Compliance Department better. And it was a very good working relationship. Q: And do you believe Mr. Delaney is an honest man? A: Yes. Q: With you? A: Yes. Q: And with regulators? A: Yes.”); Yancey Test. at 1910:1-5 (“Q: And how would you describe Mr. Delaney's character? A: Steeped in value, non-compromising, honest transparent, willing to give and take criticism, thorough, integrity.”).

Prop. FOF 64. In a January 28, 2010 quarterly 3012 meeting, Mr. Yancey was told that compliance was receiving cooperation from the relevant business units for Rule 204 remediation.

- Alaniz Test. at 845:4-19 (“Q: . . . In that January meeting, you told Mr. Washburn that you told Mr. Yancey that you were receiving cooperation from departments for remediation; is that correct? A: Yes. Q: And indeed, that was your belief, right? A: Yes. Q: Did Mr. Yancey appear to be reassured by that fact? A: I would say yes. Q: He was satisfied? A: Yes. Initially he was concerned. And after we discussed that the cooperation was forthcoming from the departments, it appeared that he was okay with that.”); Delaney Test. at 1354:6-12 (“Q: And what was Mr. Yancey told? A: Mr. Yancey was told that this was a buy-ins problem and that -- and that we had been -- the compliance group was working with the buy-ins department to remediate the issue.”); Yancey Test. at 1879:7-15 (“Q: What specifically did they tell you about buy-ins? A: . . . [T]hat prompt remediation was underway, that they had the full cooperation of the staff . . . and that further testing would begin.”); Exs. 134, 669 (January 28, 2010 email from Alaniz to Yancey stating SEC Rule 204 is now the focus of “prompt remediation”).

Prop. FOF 65. Yancey had approximately eight (8) direct reports during the relevant time period, one of whom was Delaney.

- Ex. 571 (2009 organizational chart); Ex. 570 (2010 organizational chart); Ex. 503 (2008 and 2011 organizational charts).

Prop. FOF 66. The Compliance Department conducted approximately twenty (20) Rule 3012 audits per year.

- Alaniz Test. at 714:10-12 (“I typically test around 20 items, on average, a year.”), 739:13-19 (regarding the testing cycle that ended March 31, 2010 “Q: Okay. How many different items. . . did you test during that testing cycle? A: 20, 21. Typically around the range of 20. . . . That’s the [annual] average.”).

Prop. FOF 67. Alaniz was experienced and well-trained in compliance.

- Alaniz Test. at 720:20-721:14 (“Q: [W]hat was the first financial institution you worked at? A: The very first one was 1996, ’97, Crispin Koehler Securities Q: Okay. Now, in any of those prior broker-dealers or firms, did you have a compliance role? A: Yes. Q: At all of them or just some? A: Not all. Bauer Captain & Johnson and NFP Securities.”), 833:1-824:11 (“Q: How did you come to learn about this testing process at Penson? A: I was given a book like this

(indicating) and asked to replicate it. Q: A binder? A: A binder. Q: Okay. Did you have a supervisor when you first started at Penson that told you about the testing process? A: Scott Fertig. Q: And had he established the testing process at Penson? A: I don't know if he did, but the group had tested and had examples of prior testing. Q: Okay. Had he engaged in testing before you took on that role or responsibility? A: Had he engaged in testing? Q: Engaged in testing or supervised testing? A: He supervised it. I don't know if he engaged in the actual testing. Q: Did he train you in any way with respect to the testing process or procedures? A: Yes. Q: Do you know where Scott Fertig works currently? A: The SEC. Q: What does he do? A: I don't know that. Q: Would the fact that the SEC hired him suggest to you today that perhaps you were well-trained on those testing processes? . . . A: Yes.”).

Prop. FOF 68. In his compliance role at Penson, Alaniz created and administered a comprehensive and robust 3012 testing program.

- Alaniz Test. at 705: 3-707:2 (discussing the annual 3012 testing, “A: . . . I usually start my testing four to six weeks before I write the letter . . . My basic -- basic way I come up with any audit is that I had a process. I reviewed FINRA sites, SEC sites. I would check in to our regulatory compliance [a]rea. I would ask to see what the regulators were asking about. And then from there, I would gather a list of topics. From that point, I would take it to Tom Delaney. We’d create a list. And then from there, we’d go have that list augmented or add to it if there were anything that needed to be added to it from Bill Yancey. And then from there, we’d develop what we would test throughout the year[;]” discussing the Rule 204 testing, Q: . . . how did you design that testing? A: What I do with all my audits, I bring in the groups that are responsible for the item I’m testing. So in this -- in this instance, I brought in Securities Lending department and I brought -- I brought in the buy-in department. I’d bring in managers and the VPs over them. And from there, I reviewed the rule. This was a new rule that came out; a new rule to me. I wanted to make sure that I was testing it appropriately. So I brought this group -- I brought both groups in . . . and I explained my understanding of the rule to them. And I asked them if there was any misunderstanding on my part, please point that out. This is the -- these tests are, you know, going to be written out, and they will be shown to, you know, the CEO, CCO, and it would be available to FINRA. So I did not want to mistakenly test anything that was under my misunderstanding. So when I met with them, I told them my understanding of the rule, and . . . they agreed that my understanding was their understanding. And from there, I asked all the appropriate questions about the reports that I needed to create this test.

And from there, I received the reports . . . and started my testing.”), 714:10-12 (“I typically test around 20 items, on average, a year.”), 739:13-19 (regarding the testing cycle that ended March 31, 2010 “Q: Okay. How many different items. . . did you test during that testing cycle? A: 20, 21. Typically around the range of 20. . . . That’s the [annual] average.”), 832:2-25 (“Q: You mentioned earlier that you read the relevant rules that -- on the area that you’re supposed to be testing; is that right? A: Correct. Q: And then you consult the WSPs and other procedures; is that right? A: Correct. Q: And you look to the websites for the SEC or FINRA or other areas that might have guidance? A: Correct. Q: And then you convene a group of the subject matter experts to talk about your test and what you’re looking at; is that right? A: That’s correct. Q: Is there anything else that we’re leaving out in terms of before you put your plan on paper that you do? A: That pretty much encompasses everything. . . . And you think that was a pretty good process? A: I felt that it was. Q: Okay. And it was reasonable in terms of designing a testing process? A: Yes.”); *see also* Poppalardo Test. at 1995:8-10 (“A: I thought they had a very good – a very robust Series [30]12 testing process. It was better than a lot that we’ve seen.”); Ex. 828 at 12-13.

Prop. FOF 69. In December 2009, Alaniz conducted an NASD Rule 3012 test (“the December 2009 Audit”), which tested Rule 204 close-out procedures.

- *See* Ex. 70 (Subject: SEC Rule 204); Alaniz Test. at 745:19-20 (“The focus was to ensure that the rule was being adhered to.”), 750:14-16 (“I understood the rule to require if there were any fails of T+4 or T+6, that the position in question must be bought in at – prior or at market open.”).

Prop. FOF 70. Pension’s Stock Loan department handled Rule 204(a) close out obligations for long sales of loaned securities.

- DeLaSierra Test. 305:6-306:3 (“Q: Now 204(a), we’ve discussed this has a variety of obligations, some on the customer side and some pertaining to the Stock Loan department. And I want to make sure that I have this clear for the record. You can have sales caused by a customer short; is that right? A: Yes. Q: And then you can have sales caused by a customer long sale where the customer fails to deliver; is that right? A: Correct. Q: Okay. And then -- well, and let’s work on those two. You agree that the buy-ins department had sole responsibility for closing out those fail to delivers? A: With customer shorts? Q: Oh, on a customer’s side? A: Correct. Q: Customer shorts and longs? A: Yes. Q: Okay. *And then you would agree that Stock Loan, your department, had a separate responsibility for closing out long sales due to loaned securities?* A: Correct.”) (emphasis added).

Prop. FOF 71. Alaniz did not use the term “99% violation rate” in describing the December 2009 Audit results with Yancey in the January 28, 2010 quarterly 3012 meeting.

- Alaniz Test. at 844:21 – 845:2 (“Q: And in the context of the [January] meeting, did you or Mr. Delaney use the phrase 99 percent fail rate? . . . A: I don’t recall that we discussed that percentage.”).

Prop. FOF 72. Penson’s Buy-Ins department and Penson’s Stock Loan department had separate and distinct close-out obligations.

- DeLaSierra Test. 305:6-306:3 (“Q: Now 204(a), we’ve discussed this has a variety of obligations, some on the customer side and some pertaining to the Stock Loan department. And I want to make sure that I have this clear for the record. You can have sales caused by a customer short; is that right? A: Yes. Q: And then you can have sales caused by a customer long sale where the customer fails to deliver; is that right? A: Correct. Q: Okay. And then -- well, and let’s work on those two. You agree that the buy-ins department had sole responsibility for closing out those fail to delivers? A: With customer shorts? Q: Oh, on a customer’s side? A: Correct. Q: Customer shorts and longs? A: Yes. Q: Okay. And then you would agree that Stock Loan, your department, had a separate responsibility for closing out long sales due to loaned securities? A: Correct.”); Gover Test. at 172:22-173:6 (“Q: The buy-ins department had primary responsibility for Rule 204 close-outs of fails to deliver for long sales when the failure to deliver resulted from a customer -- what we talked about earlier, a customer fail; is that fair? A: It’s -- yes, it’s accurate. Q: And then if the fail arose from -- because of a long sale of a loan security, that was Stock Loan’s obligation, correct? A: That is correct.”).

Prop. FOF 73. Penson cleared between three (3) and five (5) million trades per day.

- Gover Test. at 165:19-166:4 (“Q: How many trades do you think Penson cleared on a daily basis? A: I had seen them between three and five million.”).

Prop. FOF 74. Alaniz’s December 2009 Audit only tested the customer fail that could not be borrowed before market open and needed to be bought in.

- Gover Test. at 168:13-22 (“the December audit was focused only to -- I had requested the audit. It was focused on the processes within my group and where we were failing.”), 169:14-170:13 (“Q: So when -- when the Division characterizes that as 112 out of 113, what was down to that last piece after you have -- you’re selling 3 to 5 million trades, clearing 3 to 5 million trades a day, it’s really just a matter of statistics,

right? I mean, that's -- would you agree that it's fair to say that's a 99 percent fail rate? A: Of that piece of my process, yeah, it was a 99 percent fail. Q: Right. They can say whatever they want and kind of point to that last final piece of the buy-ins as saying, look, that was a high fail rate. But is it fair to say that the overall picture on the number of trades that you're claiming, that it was actually a fairly small number? A: Yeah. Q: I guess the point I want to establish is that your group made an incredible effort, incredible effort at all times to comply with Rule 204(a); do you agree? A: We made -- we made an effort to comply with 204. The results of the audit showed we weren't making buy-ins, my group. The efforts weren't sufficient. But yes, the people in the group, they cared, they wanted to do the right thing, they wanted to comply with the regulations.”); *see also Yancey Test. at 903:20-25* (“You know, the way I saw it was that Penson’s doing 10 to 15, you know, million trades a week and that there’s a tiny subset of those at T+6 that will need some assistance, and we need to hone in on those – those few that remain and make sure that our systems and processes capture those.”).

Prop. FOF 75. The December 2009 Audit did not contain any language regarding a “99%” fail rate.

- *Alaniz Test. at 844:21 – 845:2* (“Q: And in the context of the [January] meeting, did you or Mr. Delaney use the phrase 99 percent fail rate? . . . A: I don’t recall that we discussed that percentage.”); *Ex. 70*.

Prop. FOF 76. The Division did not ask Mr. Johnson any questions regarding his attendance at the March 31, 2010 meeting.

- *See Johnson Test. at 513-568*.

Prop. FOF 77. Alaniz had the ability to suggest to Delaney areas or topics to include in the summary reports attached to the annual CEO certifications.

- *Alaniz Test. at 857:22 – 858:23* (“Q: But you got direction on what to include from Mr. Delaney; is that right? A: Correct. . . . Q: Have you had discussions with him about other issues, about what to include in a report or what not to include in a report . . . about what’s important and what’s not important? A: Yes. Q: And he was receptive to that? A: Yes. Q: So if you had thought it was an important issue and should have been included, you had the ability to tell him to include it? A: Yes.”).

Prop. FOF 78. Alaniz, Delaney, and other members of the Compliance department compiled and reviewed the Summary Report appended to the CEO Certification.

- Delaney Test. 1361:10-24 (“Q: . . . One of your jobs as the Chief Compliance Office is to prepare the annual 3012 report; is it not? A: It is. Q: And you do that with the assistance of the – your fellow compliance colleagues? A: That’s correct. Q: It’s a group effort? A: It’s a group effort, yes. Q: It’s a big effort? A: It is a big effort. Q: It’s an important effort? A: Yes, sir. Q: You and your department made the determination of what to include in that Summary Report, fair? A: Fair.”), 679:10-17 (“Q: . . . [Y]ou said that you’re responsible for the 3012 Summary Reports; is that right? A: I – I am ultimately responsible for the reports, yes. Q: Okay. And certainly you would have reviewed them, if necessary, and made them correct; is that correct? A: I would have, yes.”); Alaniz Test. at 719:9-12 (“Q: Who decided what was put into that report? A: Initially, I would create the template. I would put in a few items that we would discuss. And from there, I would send it to Tom Delaney to complete.”).

Prop. FOF 79. Delaney had ultimate responsibility to determine the contents of the Summary Report, including what constituted a “key compliance issue.”

- Delaney Test. at 673:18-20 (“Q: Okay. And at Penson, you were responsible for contents of the 3012 report; isn’t that right? A: I was.”); Alaniz Test. at 719:13-15 (“Q: Okay. So who was it that decided whether items would be listed as significant compliance problems? A: I would ask Tom Delaney on that.”); *see also* Yancey Test. at 1886:22 – 1887:4 (“Q: And who decides what to include on this Summary Report? A: Tom Delaney. Q: Is it his judgment alone about what to include? A: I believe that Tom takes input from the staff, from the department heads, so ultimately, it is his decision, but I think he take[s] input[.]”); Delaney Test. at 1361:22 – 1363:1 (“Q: You and your department made the determination of what to include in that Summary Report, fair? A: Fair. . . . Q: Do you believe that Mr. Yancey, as the Chief Executive Officer of Penson, was entitled to rely on the judgment of you and all of your subordinates in the Compliance department as to what information should be included in the Summary Report? A: Yes. Q: Do you know of any reason whatsoever that Mr. Yancey should have overruled the judgment of the Compliance department about what should go in that report? A; No.”); Ex. 828 at 18 (Poppalardo Report).

Prop. FOF 80. At the March 31, 2010 meeting, John Kenny and Brian Gover engaged in a discussion lasting approximately fifteen (15) minutes regarding Rule 204 remediation efforts.

- Alaniz Test. at 795:7-21 (Regarding the March 31, 2010 meeting, “A: From the discussions that John Kenny had with Brian [Gover], they had – they had discussed remediation issues or remediation communication items to conform with the rule and I had no issue with that. Q: You had no issue with the remediation they discussed? A: No. . . . Q: Okay. So whether they were – had been in substantial compliance when you did your testing, you understood they were on the road to substantial compliance when you were in this [March] meeting; is that right? A: Yes.”), 851:20 – 852:16 (“Q: And the discussion on the Rule 204 test was an update on the remediation measures; is that right? A: The discussion of 204 was more with the issues that were found and also of the remediation that the – the subject matter experts were implementing. . . Q: And you previously testified that, in fact, Mr. Gover and Mr. Kenny engaged in a 15-minute or so discussion of the remediation efforts; is that right? A: Yes. Q: Do you remember specifically what they said? A: He asked Brian Gover what the issue was and Brian Gover responded. At that point, there was a conversation between them. At that point, he asked him what he was doing to rectify the situation, and he spoke about a report that they were trying to highlight to relieve the issue.”).

Prop. FOF 81. The Division did not ask Mr. Gover any questions regarding the November 2010 OCIE response language that he authored.

- See Gover Test. at 74-198.

Prop. FOF 82. Delaney did not intend to change the meaning of the language in Brian Gover’s original draft of Penson’s November OCIE response when he modified the statement to read: “Penson believes that the reasonable processes employed to close-out positions that were allegedly in violation of Rule 204T were effective and performed as designed.”

- Delaney Test. at 1284:1-16 (“Q: What changes did you make? A: I -- I added that Penson believes – where Brian had originally crafted ‘Penson feels that the processes and procedures employed,’ I added the word ‘reasonable’ in front of processes and removed the term ‘procedures.’ And – Q: I suppose -- I suppose we ought to know that you put, ‘Penson believes,’ and he put, ‘Penson feels.’ A: I did. I did change ‘feels’ to ‘believes.’ Q: Were you attempting -- to the best of your recollection, were you attempting to change the meaning of this at all? A: Absolutely not.”).

Prop. FOF 83. When Penson prepared examination responses, the Compliance department relied on input from the business units and the “subject matter experts” in each department.

- Hasty Test. at 1734:24-1735:24 (“Q: . . . Can you tell us generally what Penson's response -- or what Penson’s process was for compiling an exam response? A: . . . So when we receive an exam notification or a closing letter that had -- that requires a response, we go through the same process. It’s distributed – it was distributed out to everybody, including senior management, including all the different business owners, . . . And then Kim and/or I, just kind of depended on who was working on which exam.”); *see also* Delaney Test. at 1279:16-1280:8 (“Q: And you said, ‘a shell of the document would be sent out.’ . . . Q: And who would you send it to? A: So it would go out, like I said, to the various subject matter experts who had the expertise on the particular issue. So we wouldn't send the letter out in whole, necessarily, we might just send a cut-and-paste of a particular section. And that would go to that subject matter expert for -- for their comment and response. . . . Q: Who did you rely on for the accuracy of the documents? A: Those subject matter experts who -- who understood their business.”).

Prop. FOF 84. Holly Hasty, Penson’s Deputy CCO, signed Penson’s November 24, 2010 OCIE response.

- *See* Ex. 101 at 12.

Prop. FOF 85. Bill Yancey is honest, ethical, and full of integrity.

- Miller Test. at 2603:11-23 (“Q: Do you think Mr. Yancey -- in your experience, was he an honest man? A: Yes. Q: What -- in your own words, describe your views of Mr. Yancey. A: Any conversation that I ever had with Bill was always about doing the right thing. There was never a conversation that I had with him where he even missed a beat on making the right decision. He's a good man. Q: Is he someone that you could ever imagine putting profits ahead of compliance? A: No.”); Gover Test. at 176:18-177:6 (“Q: Did -- did you believe Bill Yancey was a man of good morals? A: Yes. Q: Did you believe that Bill Yancey was a do-the-right-thing kind of person? A: Yes . . . Q: And do you believe that Mr. Yancey had high ethical standards? A: Yes.”); Wetzig Test. at 423:19-424:5 (“A: I think Bill Yancey is one of the finest gentlemen that I know. Q: Does he have high integrity? A: He does. . . . Q: Do you think he's honest? A: I do.”); Delaney Test. at 1328:13-15 (“A: Mr. Yancey is -- Mr. Yancey exhibits a -- Mr. Yancey is a -- he exhibits a lot of integrity. He's an honest man.”); Pendergraft Test. at 1483:18-1484:2 (discussing when he hired

Yancey, "We wanted someone who had a passion for excellence, who had a passion for people, had a passion for integrity. We clearly wanted someone who had industry experience and capabilities and the skill set. But we weren't hiring that as much as we were hiring someone we thought could be a great leader of the organization. Q: You had seen those characteristics and skills in Mr. Yancey when you had worked together before? A: Yes."), 1487:24-1488:1 ("Q: Would you agree that Bill Yancey is not someone who will break the rules to increase profits? A: Bill Yancey is not that kind of person."); Hasty Test. at 1753:6-9 ("Q: Is Mr. Yancey a person of high integrity? A: Yes. Q: Does he have high ethical standards? A: Yes."); Green Test. at 2253:6-2254:7 ("Q: And other than what we've already discussed, when you think of Bill, what qualities come to mind? A: Well, a lot of qualities come to mind, ethical trustworthy, responsible, a leader, a mentor. . . . A: I think Bill, over his career, the entire time that I've known him, has been advocate for improving the overall markets, has been an advocate for regulation, has been an advocate for ethical conduct"); Felder Test. at 2117:15-20 ("Q: Was he an honest person? A: Absolutely. Q: Is he a trustworthy person? A: Sure. We wouldn't have given Bill the responsibilities he had, or I wouldn't have, unless he was trustworthy."); Muschalek Test. at 2130:10-11 ("Bill Yancey is honest, he's hard-working, he's got the integrity that's unquestioned."); Giesea Test. at 2130:10-11 ("A: He is -- he is integrity. Q: A man of honesty? A: There's isn't -- I can't think of a more honest person. Q: Does he always strive to do the right thing? A: Bill always strives to do the right thing.").

Prop. FOF 86. Delaney, Alaniz, and other members of the Compliance department were more knowledgeable than Yancey regarding Penson's 3012 testing process and testing results.

- Delaney Test. at 1352:1-19 ("Q: Would you -- as the Chief Compliance Officer, would you have expected Mr. Yancey, as the Chief Executive Officer, to know more or less about Rule 204 and Rule 204 testing than Eric Alaniz in the Compliance department? A: I would expect -- I would -- Bill is a very bright man, but I would expect him to know less. Q: You -- and you heard Mr. Alaniz testify about what he did to get ready for this test; did you not? A: I did. Q: You heard him that he studied on Rule 204, he read the rule, he talked to people in the department; do you recall that? A: I do. Q: From a Chief Compliance Officer perspective, would you have expected Mr. Yancey, as the CEO, to know more or less about Rule 204 and Rule 204 testing than you? A: I would have expected him to know less.").

Prop. FOF 87. Alaniz and Delaney testified that none of the 3012 tests conducted for that year were explicitly included in the Summary Report attached to the March 31, 2010 CEO certification.

- Alaniz Test. at 857:19-21 (“Q: And you said earlier none of your 3012 testing for the year was included in that, right? A: Correct.”); Delaney Test. at 1303:8-18 (“Q: How many different tests do you recall having been run during that cycle, if you know? A: I don’t know, but it was a lot. Q: . . . Were the specific results of any of those tests disclosed in this Summary Report? A: No. Q: Not any of the tests? A: Not any of the tests.”).

Prop. FOF 88. Other than the current action, Tom Delaney has a clean record and Form U4.

- Ex. 241 (Delaney’s CRD).

Prop. FOF 89. Other than the current action, Michael Johnson has a clean record and Form U4.

- Ex. 242 (Johnson’s CRD).

Prop. FOF 90. Michael Johnson was qualified and experienced with respect to his role at Penson.

- Stip. FOF 55 (Johnson held Series 7, 24, 27, and 63 licenses); Yancey Test. at 1862:5-9 (“He’s very well-equipped. He’s got great counterparty relationships. He’s real systems oriented. He came from – he had a rich background. He came from loan department and worked at Lehman Brothers, I believe. He had a real strong background.”).

Prop. FOF 91. As a Series 27 license-holder, Phil Pendergraft was the best-qualified person to supervise Michael Johnson and Stock Lending activities.

- See Stip. FOF 82; Delaney Test. 1343:22 – 1344:9 (“Q: . . . between Mr. Yancey and Mr. Pendergraft, in your opinion, was one more qualified than the other to supervise the Stock Loan function? A: From a broker-dealer’s standpoint, I think Mr. Pendergraft was more qualified.”); Poppalardo Test. at 1962:16-24 (“Q: . . . do you have an opinion on which is the most appropriate license for supervising securities lending? A: . . . In my opinion, I think the Series 27 is the more appropriate license. . . .”).

Prop. FOF 92. Penson's Reg SHO and Rule 204 policies and procedures addressed (1) all elements of the rule, (2) set out specific procedures to follow, and (3) identified individuals and supervisors responsible for compliance.

- See Ex. 540 at 383-399; Ex. 746 at 325-341; Ex. 828 at 10-12 (Poppalardo Report).

Prop. FOF 93. Penson's departments, including Stock Loan, maintained checklists and desk procedures.

- See, e.g., Ex. 582 (CNS Desk Checklist); Ex. 519 (Deficit Report Procedures); Hasty Test. at 1713:17-1714:16 ("Q: Now, you mentioned, I think you called it maybe a desk book or something. Were there other written materials that Penson's business units relied on? A: Some of the various business units did have desktop procedures or other types of guides that they used to help them with their day-to-day activities. For example, our onboarding group put out a document called The Guide to Penson. It was something that they used not only as a checklist to help them onboard new customers, but it was also a document that they would give to customers to help them introduce them to Penson and where to go and who to contact for different things. So there were different types of documents that existed within the firm that were not part of the written supervisory procedures. Q: And so how -- what is the function of those procedures as compared to the WSPs? A: Typically, those are more user level-type manuals. They're defined to specifically instruct somebody what they should do in a particular situation. They're designed to be step-by-step guides to how you would conduct your work or your business or how you might answer a question that you might have, and not designed necessarily to provide a high-level overview."); Wetzig Test. at 393:16-23 ("Q: What about Stock Loan; did Stock Loan have a set of desk procedures? A: We essentially had a checklist of items that we needed to do every day to get our job done. . . you could refer to them as desk procedures, I would say.").

Prop. FOF 94. Penson distributed special compliance memorandums and alerts both internally to employees and externally to correspondents regarding Regulation SHO and Rule 204T/204(a).

- See Ex. 302 (Sept. 2, 2008 Special Compliance Memorandum re: Recent SEC Emergency Orders Regarding Short Selling); Ex. 729 (Sept. 29, 2008 Compliance Alert re: SEC Emergency Order/Rule 204T); Ex. 125 (Aug. 10, 2009 internal email re: Adoption of Reg SHO Rule 204); Hasty Test. at 1719:18-1720:5 ("Q: . . . What is a Special Compliance Memorandum? A: These would typically be

information that the Compliance Department would put together to distribute both internally . . . and also to our correspondents. . .”).

Prop. FOF 95. As part of its efforts to comply with new rules, including Rule 204, Penson updated and modified its procedures through technology efforts and developments. The “IT steering committee,” assisted with technology resources at Penson. Penson prioritized technology efforts and resources dedicated to regulatory compliance, such as Rule 204 compliance.

- Hasty Test. at 1715:15-1716:4 (describing working groups); 1718:13-23 (“Q: What did Penson do to ensure compliance with Rule 204? A: I know the firm updated its procedures. There was technology efforts to create new reports and new information that was being used. . .”), 1723:16-1724:14 (“Q: Were you on an IT steering committee? A: I was on an IT steering committee. Q: And what was your role? A:. . .So my role was to provide compliance guidance and also to determine whether something needed to be escalated because it was something that was regulatory and needed to be completed perhaps in front of something that would – might be considered an enhancement. Q: . . . Do you remember whether Rule 204 was something that needed to be escalated? A: I do. I specifically remember Brian Gover requesting some help with the 204 buy-in reports . . . and he had requested that I review it and escalate it through the steering committee to get development resources put on that project more quickly. Q: And did you do that? A: I did.”).

Prop. FOF 96. Penson’s Compliance department conducted several 3012 tests each quarter, which spanned a variety of regulatory areas.

- *See, e.g.,* Ex. 722 (evidencing that in one year, Penson conducted testing in at least 14 different areas); Alaniz Test. at 714:10-12 (“I typically test around 20 items, on average, a year.”), 705:6-19 (discussing the annual 3012 testing, “A: . . . I reviewed FINRA sites, SEC sites. I would check in to our regulatory compliance [a]rea. I would ask to see what the regulators were asking about. And then from there, I would gather a list of topics. From that point, I would take it to Tom Delaney. We’d create a list.”); Ex. 828 at 12-13 (Poppalardo Report).

Prop. FOF 97. Penson employees observed that Bill Yancey was attentive during the quarterly 3012 meetings and asked detailed questions.

- *See* Ex. 692 (email from Delaney to Yancey and others stating “We continue to appreciate your participation in this process as you set a meaningful tone at the top related to compliance efforts of the firm.”);

Alaniz Test. at 837:8-18 (“Q: Was Mr. Yancey engaged during the course of those [3012] meetings? A: Yes. Q: Was he attentive? A: Yes. Q: And he showed interest in what you were doing? A: Yes. Q: Did he ask some questions? A: Yes.”).

Prop. FOF 98. In 2008, Pendergraft directed the Vice President of Human Resources, Dawn Gardner, to move Johnson from PFSI to PWI.

- See Ex. 608 (August 14, 2008 email from Pendergraft to Dawn Gardner) (“Dawn: Effective with the 8/31 payroll, Mike Johnson should be moved to PWI payroll, and his salary adjusted to 600k per year.”); Gardner Test. at 1150:16-20 (“Q: What do you recall about this document? A: It was instructions from Phil for me to move Mike Johnson over from PFSI to PWI and to adjust his payroll.”).

Prop. FOF 99. Before August 2008, Penson’s organization charts listed Johnson as a PFSI employee reporting to Yancey.

- Ex. 555.

Prop. FOF 100. After August 2008, Penson’s organization charts listed Johnson on the same level as Yancey, reporting to Pendergraft, Engemoen, and Son.

- Ex. 571.

Prop. FOF 101. Johnson told Penson employees that he reported to Pendergraft.

- Gardner Test. 1152:1-6 (“Q: Was Mike Johnson proud of who he reported to? A: Yes, he was. Q: How do you know that? A: Because he told everyone that he was working as the-the Senior Vice President of Global Stock Loan and he was reporting to Phil Pendergraft at Penson Worldwide.”); McCain Test. 2182:5-15 (“ . . . Mike made it clear to everybody that he reported to Phil. There wasn’t any question as to who reported to who. If anybody had any question, Mike would set you straight real fast”); Hasty Test. at 1743:25-1744:6 (“Q: Would you -- you said Mike said he reported to Phil Pendergraft. Would you say he was proud of who he reported to? A: Yes. Q: Would you say he would brag about who he reported to? A: Yes.”), 1794:24-1795:4 (“I mean, Mike Johnson is not a quiet person. He was very vocal about who he reported to and where he got his directions and how, if something were to come up, who he was going to take his orders from.”); Delaney Test. at 1338:2-1338:13 (“Q: I apologize for this question, because you may have been the witness to say it, but during this trial, have you heard testimony about Mr. Johnson proudly and publicly stating that he reported only to Mr. Pendergraft? A: That was my testimony and I heard other testimony that stated that. Q: And that,

in fact, not only did he report to Mr. Pendergraft, but that he specifically and explicitly did not report to and was not was not supervised by Mr. Yancey? A: Yes.”).

Prop. FOF 102. Penson employees were not confused about who Johnson reported to.

- Gardner Test. at 1153:24-1154:2 (“Q: Ms. Gardner, are you aware of anyone in the company that was confused about who supervised Mike Johnson? A: No.”); Hasty Test. at 1745:13-16 (“Q: Are you aware of anyone at the Penson organization who was confused about who Mike Johnson was supervised by? A: No.”); Delaney Test. at 1336:10-13 (“Q: To your knowledge, Mr. Delaney, was there anyone in the Penson organization who was confused about who Mr. Johnson’s supervisor was? A: No.”); McCain Test. at 2194:9-16 (“Q: In your mind, was there any confusion about who Mike Johnson reported to? A: Absolutely not. And Mike, everybody knew who Mike reported to. Everybody knew who everybody reported to, frankly. But there was never any question as to who Mike reported to. And if you didn’t—if you had any question, Mike would set you straight real fast”).

Prop. FOF 103. During at least a portion of the relevant time period, Holly Hasty supervised Kim Miller.

- Hasty Test. at 1725:12-15 (“Q: Okay. And who -- I think you said that Kim Miller didn't report to you early on, but by this point, was she reporting to you? A: Yes, she was.”).

Timeline of Significant Events

Date	Event	Support
Aug 2005	Bill Yancey joins PFSI as President and CEO	Tr. 1811:15-16
Feb 2006	Mike Johnson reports to Bill Yancey until August 2008	Ex. 555 at 3; Prop FOF 6
August 2008	Mike Johnson is promoted from PFSI to PWI; Bill Yancey delegates supervisory responsibility for Mike Johnson to Phil Pendergraft; Phil Pendergraft supervises Johnson; Yancey follows up	Exs. 571, 608; Stip. FOF 9, 76, 88; Prop. FOF 6, 9, 11
August 2008- End of 2008	Phil Pendergraft supervises Mike Johnson in all respects; Bill Yancey follows up	Ex. 792; Stip. FOF 76, 88; Prop. FOF 9, 11
9/18/2008	Temporary Interim Emergency Rule 204T announced	Stip. FOF 4
9/21/2008	Phil Pendergraft edits Compliance Alert to sent by Penson to its clients related to emergency Rule 204T	Exs. 813, 531
10/17/2008	Interim Temporary Final Rule 204T adopted	Ex. 67
11/6/2008	SEC's Office of Compliance, Inspection, and Examination (OCIE) serves PFSI with request for production of documents as part of a Reg SHO examination	Ex. 752
2009	Phil Pendergraft supervises Mike Johnson in all respects; Bill Yancey follows up	E.g., Exs. 795, 707; Stip. FOF 76, 88; Prop. FOF 9, 11
1/9/2009	Penson organizational chart reflects Mike Johnson reporting to PWI	Ex. 571
7/31/2009	Rule 204T becomes permanent	Ex. 69; Stip. FOF 4
December 2009	Eric Alaniz conducts 3012 Rule 204 audit (204(a) results relate only to the Buy Ins Department—fails arising from long sales of loaned securities are not tested)	Ex. 70; Stip. FOF 78
2010	Phil Pendergraft supervises Mike Johnson in all respects; Bill Yancey follows up	E.g., Exs. 668, 517, 793, 788; FOF 76, 88; Prop. FOF 9, 11
1/28/10	Quarterly 3012 meeting attended by Bill Yancey, Tom Delaney, and Eric Alaniz; Compliance assures Bill Yancey that, as a result of the December 2009 Audit, Rule 204 is “the focus of prompt remediation” and that the various Penson departments were cooperating in remediation effort	Ex. 669; Prop. FOF 64
3/31/10	Quarterly 3012 meeting attended by Bill Yancey, Tom Delaney, Eric Alaniz, and others; Rule 204 remediation efforts are discussed; Eric Alaniz, not Bill Yancey, invited Mike Johnson. Although Mike Johnson cannot attend, he sends a representative from Stock Loan	Exs. 507, 633; Stip. FOF 96, 113; Prop. FOF 24, 31, 32, 44, 80

3/31/10	Annual 3130 CEO Certification Meeting attended by Bill Yancey, Tom Delaney, and Eric Alaniz; Compliance Department prepares Summary Report attached to CEO certification; PFSI makes 3012 testing files available to regulators	Ex. 135 at 7; Stip. FOF 21; Prop. FOF 26
6/17/10	Follow up 3012 test on Rule 204 is conducted—shows significant improvement	Ex. 85; Prop. FOF 5
8/2/10	Quarterly 3012 meeting attended by Bill Yancey, Tom Delaney, and Eric Alaniz; Remediation efforts arising from December audit discussed	Ex. 92; Stip. FOF 40
Fall 2010	Eric Alaniz spot checks Buy Ins Department's Rule 204 compliance and finds 100% compliance	Prop. FOF 5
10/27/10	OCIE issues deficiency letter to PFSI, which includes discussion of Rule 204 issues	Ex. 203
11/8/10	Brian Gover prepares and circulates draft response to OCIE exam deficiency letter	Stip. FOF 30
11/24/10	Penson sends formal response to OCIE deficiency letter; Response is reviewed by Tom Delaney (CCO) and Holly Hasty (Deputy CCO)	Ex. 101; Prop. FOF 37
2011	Phil Pendergraft continues supervising Mike Johnson; Bill Yancey follows up	E.g., Exs. 684, 563, 638, 730, 502, 783, 684; Stip. FOF 76, 88; Prop. FOF 9, 11
2/15/11	Call between PFSI Compliance, Stock Loan department, and Morgan Lewis regarding Rule 204 compliance	Prop. FOF 8
4/31/11	Tom Delaney leaves PFSI	Stip. FOF 57
6/7/11	Penson organizational charts reflect Mike Johnson reporting to Phil Pendergraft	E.g., Ex. 503
2/15/12	Bill Yancey leaves PFSI	Tr. 1823:14-15

December 19, 2014

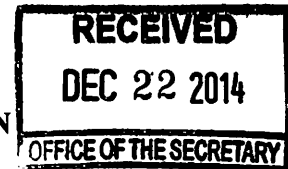
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CHARLES W. YANCEY**

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-15873

In the Matter of

**Thomas R. Delaney II and
Charles W. Yancey**

Respondents

RESPONDENT CHARLES W. YANCEY'S PROPOSED CONCLUSIONS OF LAW

Respondent Charles W. Yancey ("Yancey"), by and through counsel, submits these Proposed Conclusions of Law.

Pursuant to the Court's post-hearing order (*Thomas R. Delaney II*, Admin. Proc. Rulings Release No. 2011, 2014 SEC LEXIS 4305 (Nov. 13, 2014)), this submission also includes Stipulated Conclusions of Law, as well as the pages(s) and line(s) in the hearing transcript on which they were made. Yancey's Proposed Conclusions of Law are numbered Prop. COL 1-42 and include the legal authority on which they are based.

Previously Agreed and Stipulated Conclusions of Law

- COL 1. Rule 204T/204 requires participants of a registered clearing agency to deliver equity securities to a registered clearing agency when delivery is due; that is, by settlement date. As relevant here, settlement date is generally three days after the trade date (“T+3”). For short sales, if the participant does not deliver securities by T+3 and has a failure-to-deliver position at the clearing agency (also referred to as CNS fails/failures to deliver), at market open on the morning of T+4 it must take affirmative action to close out the failure-to-deliver position by purchasing or borrowing the securities of like kind and quantity by no later than the beginning of regular trading hours on the settlement day following the settlement date (“T+4”). For long sales, if the participant has a failure-to-deliver position at the clearing agency (also referred to as CNS fails/failures to deliver), at market open on the morning of T+6 it must take affirmative action to close out the failure-to-deliver position by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours on the third day following the settlement date (“T+6”). **Tr. pp. 2292:7 – 2293:15.**
- COL 2. The Division bears the burden of proof on all of the Division’s claims against Delaney and Yancey. **Tr. p. 2533:4-7.**
- COL 3. If adjudicated facts are subject to competing inferences, the Division, as the party with the burden of proof, must establish that its inferences are more plausible than Respondents’ inferences. **Tr. p. 2533:18-25.**
- COL 4. If the record equally supports both innocent and culpable inference, the Division fails in its burden of proof. **Tr. p. 2534:1-9.**
- COL 5. To establish that one Respondent willfully aided and abetted the violation of another, the Division must show that the aider and abettor acted with scienter. **Tr. p. 2534:11-18.**
- COL 6. Willfulness is shown where a person intends to commit an act that constitutes a violation. **Tr. p. 2537:14-19.**
- COL 7. To satisfy the substantial assistance element of aiding and abetting, the SEC must show that the defendant in some sort associated himself with the venture, that he participated in it as something that he wished to bring about, and that he sought by his action to make it succeed. **Tr. p. 2539:8-18.**
- COL 8. The primary violation must be a direct or reasonably foreseeable result of the aider and abettor's conduct to satisfy the substantial assistance element. **Tr. pp. 2539:19-2540:2.**

COL 9. Generally, the delegation of supervisory responsibility is reasonable when (1) the person to whom the responsibilities are delegated possesses sufficient knowledge and experience to perform those functions in a satisfactory manner and (2) the person who has delegated supervisory responsibilities to another takes reasonable steps to ensure that the functions delegated are being performed in reasonable manner. **Tr. p. 2571:5-8.**

Yancey Proposed Conclusions of Law

Failure to Supervise

Prop. COL 1. **Section 15(b)(4)(E) of the Securities and Exchange Act authorizes the Securities and Exchange Commission to impose sanctions on an associated person if that person has failed to reasonably supervise, with a view to preventing violations of the federal securities statutes, rules, and regulations, another person who commits such a violation, and if such other person is subject to his supervision.**

Securities Exchange Act of 1934, §§ 15(b)(6)(A)(i), 15(b)(4)(E).

Prop. COL 2. **In satisfying its burden on a failure to supervise claim, the Division must prove each of the following elements:**

- (1) an underlying securities law violation by another person;**
- (2) association of the registered representative or person who committed the violation;**
- (3) supervisory jurisdiction over that person; and**
- (4) failure to reasonably supervise the person committing the violation.**

In the Matter of Dean Witter Reynolds, Inc., SEC Administrative Proceeding File 3-9686, Initial Decision Release No. 179, 2001 WL 47244 at *38 (Jan. 22, 2001); *In the Matter of Michael Bresner*, SEC Administrative Proceeding File 3-315015, Initial Decision Release No. 517 at 115 (Nov. 18, 2013).

Prop. COL 3. **While neither scienter nor willfulness is an element of a failure to supervise charge, “scienter may be considered in evaluating the reasonableness of supervision.”**

In the Matter of Angelica Aguilera, SEC Administrative Proceeding File 3-14999, Initial Decision Release No. 501, 25 (July 31, 2013); *In the*

Matter of Clarence Z. Wurts, 54 S.E.C. 1121, 1132 (Jan. 16, 2001). See also *In the Matter of Charles F. Kirby*, SEC Administrative Proceeding File No. 3-9602, Initial Decision No. 177, 2000 WL 1787908 *20-23 (Dec. 7, 2000) (where supervisor had no reason to suspect supervisee was violating securities laws, such fact weighed in favor of finding supervision was reasonable).

I. Underlying Violation

Prop. COL 4. **Where the Division fails to satisfy its burden that an underlying violation of the securities laws occurred, a failure to supervise claim predicated on that same underlying violation must likewise fail.**

In the Matter of IFG Network Sec., Inc., Exchange Act Release No. 34-54127, 88 SEC Docket 1195, 2006 WL 1976001 (July 11, 2006) (“Since the alleged violations of the three registered representatives are unproved, it must be concluded that the failure to supervise charge against IFG and Ledbetter is also unproved.”);

In the Matter of Bresner, Exchange Act Release No. 34-68464, 2012 WL 6608195, at *2 (Dec. 18, 2012) (denying as inefficient a request to sever action against supervisor and representative because, “as in all failure-to-supervise cases, the underlying violation must be proven as the first step in substantiating a charge of supervisory failure against [the supervisor]”).

Prop. COL 5. **There are three essential elements to an aiding and abetting claim:**

- (1) the existence of a securities law violation by the primary party;**
- (2) awareness or knowledge by the aider and abettor that his role was part of an overall activity that was improper; and**
- (3) that the aider and abettor knowingly and substantially assisted in the conduct that constituted the primary violation.**

In the Matter of OptionsXpress, Inc., SEC Administrative Proceeding File 3-14848, Initial Decision Release No. 490, 2013 WL 2471113, at *79 (June 7, 2013); see also *Woods v. Barnett Bank*, 765 F.2d 1004, 1009 (11th Cir. 1985); *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir. 1980).

II. Association of the Registered Representative

Prop. COL 6. **Mr. Yancey does not dispute that both Mr. Johnson and Mr. Delaney were registered representatives and associated persons of PFSI.**

III. Supervisory Jurisdiction over that Person

a. Delegation

Prop. COL 7. **For purposes of Section 15(b)(4)(E), a supervisor has been defined as:**

A person at the broker-dealer who has been given (and knows or reasonably should know he has been given) the authority and the responsibility for exercising such control over one or more specific activities of a supervised person . . . so that such person could take effective action to prevent a violation of the Commission's rules which involves such activity or activities by such supervised person.

In the Matter of Michael Bresner, SEC Administrative Proceeding File 3-315015, Initial Decision Release No. 517 at 115 (Nov. 18, 2013); *see also In the Matter of Patricia Ann Bellows*, SEC Administrative Proceeding File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *8 (July 23, 1998); *In the Matter of Huff*, 50 S.E.C. 524, 532, 1991 WL 296561, at *9 (March 28, 1991) (supervisors require the power to control the actions of their subordinates).

Prop. COL 8. **A supervisory relationship “can only be found in those circumstances when, among other things, it should have been clear to the individual in question that he was responsible for the actions of another and that he could take effective action to fulfill that responsibility.”**

In the Matter of Huff, Securities and Exchange Release No. 29017, 1991 SEC Lexis 551 at *18-19 (1991) (concurring opinion of Commissions Lochner and Schapiro).

Prop. COL 9. **A president and CEO of a firm “is responsible for the firm's compliance with all applicable requirements unless and until he reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his or her duties.”**

John B. Busacca III, Exchange Act Release No. 63312, 99 SEC Docket 34481, 34496 (Nov. 12, 2010).

- Prop. COL 10. **“A firm’s president is not automatically at fault when other individuals in the firm engage in misconduct of which he has no reason to be aware.”**
- In the Matter of Swartwood Hesse, Inc.*, Exchange Act Release No. 34-31212, 1992 WL 252184 at *6 (Sept. 22, 1992) (quoting *In the Matter of Juan Carlos Schidlowski*, 48 S.E.C. 507, 509 (1986)).
- Prop. COL 11. **The Commission “has long recognized that individuals . . . who may have overarching supervisory responsibilities for thousands of employees must be able to delegate supervisory responsibility”**
- In the Matter of Patricia Ann Bellows*, SEC Administrative Proceeding File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *8 (July 23, 1998).
- Prop. COL 12. **The act of delegation need not be formal or written.**
- In the Matter of Swartwood Hesse, Inc.*, Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *5 (Sept. 22, 1992) (“the fact that there was no written documentation to support this division of authority is not dispositive of the issue”);
- In the Matter of Raymond James*, SEC Administrative Proceeding File 3-11692, Initial Decision Release No. 296, 2005 WL 2237628 at * 47 (Sept. 15, 2005) (“The fact that [broker dealer’s] CEO did not formally delegate to [delegatee] responsibility for the design, adoption and implementation of [broker dealer’s] supervisory procedures does not change the fact that [delegatee] was responsible for supervising [supervisee]. [Delegatee] controlled [supervisee’s] activities,” and was responsible for hiring and firing supervisee).
- In the Matter of Thomas F. White*, Exchange Act Release No. 34-34398, 57 SEC Docket 481, 1994 WL 389903 at *2-3 (July 19, 1994) (finding president delegated supervisory authority where president “assigned” supervisory authority to delegatee and supervisee stated that he discussed all matters that he had discussed with former supervisor with delegatee).
- Prop. COL 13. **Delegation can take place through the actions and words of the parties involved, which include the delegator, delegatee, and supervisee.**
- In the Matter of Swartwood Hesse, Inc.*, Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *6 (Sept. 22, 1992) (where all parties testified about delegation of supervisory authority, Commission concluded president successfully delegated supervisory authority to

another, even if no formal delegation and even if broker-dealer's trader testified that he had "no idea" whether president delegated his "compliance responsibility");

In the Matter of Thomas F. White, Exchange Act Release No. 34-34398, 57 SEC Docket 481, 1994 WL 389903 at *2-3 (July 19, 1994) (finding president delegated supervisory authority where president "assigned" supervisory authority to delegatee and supervisee stated that he discussed all matters that he had discussed with former supervisor with delegatee).

Prop. COL 14. **A delegation occurs when, through the actions and words of the involved parties, the involved parties understand that supervision has been delegated.**

In the Matter of Universal Heritage Investments Corp., 47 S.E.C. 839, 845, 1982 WL 525157 at *5 (1982) (finding delegation where president delegated responsibility for day to day responsibility of firm to another);

In the Matter of Swartwood Hesse, Inc., Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *6 (Sept. 22, 1992) (where all parties testified about delegation of supervisory authority, Commission concluded president successfully delegated supervisory authority to another, even if no formal delegation and even if broker-dealer's trader testified that he had "no idea" whether president delegated his "compliance responsibility");

Prop. COL 15. **The testimony of those other than the delegator, delegatee, and supervisee may be relevant in deciding whether delegation has occurred.**

In the Matter of Swartwood Hesse, Inc., Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *6 (Sept. 22, 1992) (looking to the testimony of others to decide whether supervisory authority had been delegated).

Prop. COL 16. **The *Gutfreund* facts and circumstances test is relevant in deciding whether delegation has occurred.**

In the Matter of Patricia Ann Bellows, SEC Administrative Proceeding File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *9 (July 23, 1998) (citing to the *Huff* test of "who had control over the individual acts of the [supervisee]" as the standard for deciding whether delegation has occurred, and using the *Huff* standard to conclude that

president¹ of broker-dealer had delegated supervisory authority to another individual, and, therefore, was not liable for failing to supervise individual) (citing *Arthur James Huff*, 43 SEC Docket 878, 891 (Mar. 28, 1991));

SEC v. Yu, 231 F.Supp.2d 16, 20-21 (D.D.C. 2002) (relying on *Gutfreund* standard to conclude that president of broker-dealer had not delegated his supervisory authority. The court specifically noted that “the Commission has long taken the position that a person's classification as a ‘supervisor’ turns on ‘whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of employees’” and relied on facts and circumstances showing that president retained power to “affect the conduct of the employee[s] whose behavior is at issues,” “advise[e] on compliance issues,” “consult[] on issues including the termination of registered representatives, the supervision of compliance personnel and the hiring of a compliance Inspector” to come to its supervisory conclusion) (citing *In the Matter of Gutfreund*, Exchange Act Release No. 31554, 1992 WL 362753 at *15 (1992));

In the Matter of Midas Sec., LLC, Exchange Act Release No. 34-66200, 2012 WL 161938 at *13 (Jan. 20, 2012) (in conducting delegation analysis, Commission looked to the *Gutfreund* factors when deciding whether president had delegated supervisory authority to alleged delegatee. The Commission stated “[i]n addition, [president] admitted that [alleged delegatee] could not incur office expenses on behalf of the Firm and could not hire, fire, or approve the registered representatives' leave from the office—i.e., indications that could otherwise signal [alleged delegatee's] supervisory authority over the registered representatives”);

In the Matter of Raymond James, SEC Administrative Proceeding File 3-11692, Initial Decision Release No. 296 (Sept. 15, 2005) (in delegation case, citing both *Huff* and *Gutfreund* and noting that the “most probative factor as to whether a person is responsible for actions of another is the power to control another’s conduct”).

Prop. COL 17.

Under *Gutfreund*, “determining if a particular person is a supervisor depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue.”

In the Matter of John H. Gutfreund, 51 S.E.C. 93, 113 (Dec. 3, 1992); *In*

¹ Although the delegator did not have the title of president or CEO, the court conducted its delegation analysis as if the delegator were the president. *In the Matter of Patricia Ann Bellows*, SEC Administrative Proceeding File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *9 (July 23, 1998).

the Matter of Theodore W. Urban, SEC Admin. Proc. File 3-13655, Initial Decision Release No. 402 (Sept. 8, 2010); *see also In the Matter of George Kolar*, 202 SEC LEXIS 3420 (June 26, 2002).

Prop. COL 18.

Under *Gutfreund*, non-exclusive indicia of supervisory authority include the ability to:

- **Discipline.** *See In the Matter of Ronald S. Bloomfield*, Exchange Act Release No. 34-71632, 2014 WL 768828, at *11 (Feb. 27, 2014) (“As we have held, an individual’s ability to discipline and, especially, to fire an employee are indicia of supervisory authority over that employee.”); *see also In the Matter of Midas Sec., LLC*, Exchange Act Release No. 34-66200, at *13 & n.73, 2012 WL 161938 (Jan. 20, 2012); *In the Matter of George J. Kolar*, Exchange Act Release No. 46127, 55 SEC 1009, 2002 WL 1393652, at *4 (June 26, 2002);
- **Advise about the specific regulatory rule at issue.** *In the Matter of Arthur James Huff*, Exchange Act Release No. 34-29017, 1991 WL 296561 at *9 (March 28, 1991);
- **Authority to affect conduct at issue.** *In the Matter of Ronald S. Bloomfield*, Exchange Act Release No. 34-71632, 2014 WL 768828, at *11 (Feb. 27, 2014) (“With respect to the [branch office’s] activities, [alleged supervisor] testified that he believed that he had “unfettered” authority to act as necessary, including the authority to dismiss [the supervisee], to “shut down” [the supervisee’s] penny stock business, and to close the [branch office].”);
- **Fire.** *In the Matter of Midas Sec., LLC*, Exchange Act Release No. 34-66200, 2012 WL 161938 at *13 (Jan. 20, 2012) (“In addition, Lee admitted that Cantrell could not incur office expenses on behalf of the Firm and could not hire, fire, or approve the registered representatives’ leave from the office—*i.e.*, indications that could otherwise signal Cantrell’s supervisory authority over the registered representatives”);
- **Assess performance.** *See In the Matter of Theodore W. Urban*, SEC Administrative Proceeding File 3-13655, Initial Decision Release No. 402, 2010 WL 3500928, at *27 (September 8, 2010);
- **Assign, direct, or approve activities.** *See id.*;
- **Promote.** *See id.*; and
- **Approve leave.** *Midas*, 2012 WL 161938, at *13.

Prop. COL 19. **Contradictory evidence as to delegation does not demonstrate that there was confusion in the supervisory structure.**

In the Matter of Swartwood Hesse, Inc., Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *5 (Sept. 22, 1992) (“the fact that there was no written documentation to support this division of authority is not dispositive of the issue”).

Prop. COL 20. **No one piece of evidence, including a specific document or specific witness testimony, is dispositive of delegation.**

In the Matter of Swartwood Hesse, Inc., Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *5 (Sept. 22, 1992) (“the fact that there was no written documentation to support this division of authority is not dispositive of the issue” and finding delegation even where broker-dealer’s trader testified that he had “no idea” whether president delegated his “compliance responsibility”).

b. Reasonableness of Delegation

Prop. COL 21. **See Conclusion of Law No. 9 for the standard for reasonable delegation.**

Prop. COL 22. **A president of a broker-dealer may reasonably rely on his or her qualified supervisory delegates to properly supervise individuals. Follow-up is reasonable where the president has in person or other meetings or communications with the delegatee, and receives no indication of wrongdoing.**

In the Matter of Universal Heritage Investments Corp., 47 S.E.C. 839, 845, 1982 WL 525157 *2 (1982) (finding no failure to supervise where president of broker dealer delegated supervisory authority to another and president “met with [delegatee] several times a month to discuss the firm’s operations”);

In the Matter of Swartwood Hesse, Inc., Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *5 (Sept. 22, 1992) (delegator not liable for failing to supervise when “the record does not show that, during the relevant period, [president] had the slightest indication of any irregularity in [supervisee’s] activities, that any irregularity was brought to his attention, or that he had reason to believe he could not trust [delegates] to perform his functions in a proper manner.”).

Prop. COL 23. **A delegator's follow-up need not be so robust that it would fall into the category of actual supervision.**

In the Matter of Swartwood Hesse, Inc., Exchange Act Release No. 34-31212, SEC Docket 1557, 1992 WL 252184 at *5 (Sept. 22, 1992) (Commission finds that Division's argument that delegator-president should have "regularly reviewed order tickets and trading blotters, and periodically monitored the NASDAQ Level III quotation machine, all of which might have detected [supervisee's] fraud" is misplaced because "given the division of responsibility between [delegator] and [delegatee], [delegator] was not required to do any of those things.")

IV. Reasonable Supervision

Prop. COL 24. **The standard for supervision is whether a person exercises "reasonable supervision under the attendant circumstances."**

In the Matter of Eric J. Brown et. al., Exchange Act Release No. 34-66469, 2012 WL 625874 at *11 (Feb. 28, 2012); *see also In the Matter of Theodore W. Urban*, SEC Administrative Proceeding File 3-13655, Initial Decision Release No. 402 at 52 (September 8, 2010).

Prop. COL 25. **Negligence is the applicable standard in assessing whether supervision was reasonable under the prevailing circumstances.**

In the Matter of Theodore W. Urban, SEC Admin. Proc. File 3-13655, Initial Decision Release No. 402 at 52 (Sept. 8, 2010) (citing *Kevin Upton*, 52 S.E.C. 145, 153 (1995), *rev'd on other grounds*, 75 F.3d 92 (2d Cir. 1996)).

Prop. COL 26. **"Negligence is defined as: '[t]he failure to exercise the standard of care that a reasonably prudent person would have exercised in a similar situation; any conduct that falls below the legal standard established to protect others against unreasonable risk of harm, except for conduct that is intentionally, wantonly, or willfully disregarding of others' rights. The term connotes culpable carelessness.'"**

In the Matter of Theodore W. Urban, SEC Admin. Proc. File 3-13655, Initial Decision Release No. 402 at 52 (Sept. 8, 2010) (quoting Black's Law Dictionary 1056 (7th ed. 1999)).

Prop. COL 27. **“The reasonable person acts sensibly, does things without serious delay, and takes proper but not excessive precautions.”**

In the Matter of Theodore W. Urban, SEC Admin. Proc. File 3-13655, Initial Decision Release No. 402 at 52 (Sept. 8, 2010).

Prop. COL 28. **The standard for supervision is not perfection. Even if supervision “was not perfect,” or a factual analysis indicates that a more thorough investigation might have revealed a supervised employee’s misconduct, liability does not exist in the absence of *unreasonable* supervision.**

In the Matter of Arthur James Huff, Exchange Act Release No. 34-29017, 1991 WL 296561 at *4 (March 28, 1991) (finding that “more thorough investigation by [the supervisor] might have revealed. . . misconduct. However, the statute only requires reasonable supervision under the attendant circumstances”);

In the Matter of Patricia Ann Bellows, SEC Administrative Proceeding File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *9 (July 23, 1998) (“I conclude that the supervision . . . was not perfect, and a factual analysis indicates that a more thorough investigation might have revealed [supervisee’s] misconduct. However, the statute only requires reasonable supervision under the attendant circumstances.”) (internal citations omitted).

Prop. COL 29. **“The evolution of the supervision standards is a triumph of common sense that makes oversight of the market more responsible, more accountable, and more practical.”**

In the Matter of Patricia Ann Bellows, SEC Administrative Proceeding File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *9 (July 23, 1998).

Prop. COL 30. **“The Commission, like virtually all institutions, both public and private, is not immune from the tendency of organizations to stagnate over time. Government institutions, in particular, need to guard against the stagnation born of mindless recitation of rules.”**

In the Matter of Patricia Ann Bellows, SEC Administrative Proceeding File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *9 (July 23, 1998).

Prop. COL 31. **Whether supervision is reasonable depends on the particular circumstances of each case.**

See In the Matter of Eric J. Brown et. al., Exchange Act Release No. 34-66469, 2012 WL 625874 (Feb. 28, 2012); *In the Matter of Theodore W. Urban*, SEC Administrative Proceeding File 3-13655, Initial Decision Release No. 402 (Sept. 8, 2010) (citing *Kevin Upton*, 52 S.E.C. 145, 153 (1995)).

Prop. COL 32. **Rule 3010's "reasonably designed" standard "recognizes that a supervisory system cannot guarantee firm-wide compliance with all laws and regulations," only that the system "be a product of sound thinking and within the bounds of common sense, taking into consideration the factors that are unique to a member's business."**

NASD Notice to Members 99-45 (June 1999) (NASD Provides Guidance on Supervisory Responsibilities).

Affirmative Defense

Prop. COL 33. **Section 15(b)(4)(E) of the Exchange Act and Section 203(e)(6) of the Advisers Act provides an affirmative defense to a failure to supervise claim: no person may be deemed to have failed to reasonably supervise if (1) there have been established procedures, and a system for applying such procedures, to prevent and detect any violation; and (2) the person has reasonably satisfied his duties and obligations without reasonable cause to believe that the procedures and system were not being followed.**

In the Matter of Michael Bresner, SEC Administrative Proceeding File 3-315015, Initial Decision Release No. 517, 2013 WL 5960690 at *116 (Nov. 8, 2013).

Prop. COL 34. **The respondent has the burden to prove Section 15(b)(4)(E)'s affirmative defense by a preponderance of the evidence.**

In the Matter of Michael Bresner, SEC Administrative Proceeding File 3-315015, Initial Decision Release No. 517, 2013 WL 5960690 at *3 (Nov. 8, 2013) (applying preponderance of the evidence standard to all claims, including affirmative defense).

Prop. COL 35. **There is no definition or description of a "perfect" supervisory system, nor is that the standard. Just because a system could have been "more reasonably designed" does not mean that it is unreasonable as designed.**

See In the Matter of IFG Network Sec., Inc., Exchange Act Release No. 34-54127, 88 SEC Docket 1195, 2006 WL 1976001 (July 11, 2006) (the Commission rejected the Division's arguments that the broker-dealer President failed to exercise reasonable supervision, in part because a different system would have been "more reasonably designed" to prevent the violations).

Prop. COL 36. **The reasonableness standard recognizes that "a supervisory system cannot guarantee firm-wide compliance with all laws and regulations. However, this standard does require that the system be a product of sound thinking and within the bounds of common sense, taking into consideration the factors that are unique to a [firm's] business."**

NASD Notice to Members 99-45 (June 1999) (NASD Provides Guidance on Supervisory Responsibilities).

Prop. COL 37. **A firm's written supervisory procedures should put registered personnel on notice of regulatory requirements and Firm practices, clearly vest supervisory responsibility in specific individuals, and address an array of subjects consistent with what the SEC and FINRA would reasonably expect the WSPs to contain.**

FINRA Supervisory Checklist, contained in FINRA Continuing Membership Guide, located at <http://www.finra.org/industry/compliance/registration/memberapplicationprogram/cmguide/p009725>.

Other Issues

Prop. COL 38. **To appropriately assess sanctions, a court should conduct a public interest analysis, which takes into consideration the following non-exclusive factors:**

- (1) the egregiousness of the respondent's actions;**
- (2) the isolated or recurrent nature of the infractions;**
- (3) the degree of scienter involved;**
- (4) the sincerity of the respondent's assurances against future violations;**
- (5) the respondent's recognition of the wrongful nature of his or her conduct; and**

(6) the likelihood that his or her occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd* on other grounds, 450 U.S. 91 (1981).

Prop. COL 39. **The primary purpose in imposing sanctions is not to punish a respondent, but rather to protect the public.**

In the Matter of Stephen J. Horning, Exchange Act Release No. 56886, 2007 SEC LEXIS 2796, at *24 (Dec. 3, 2007).

Prop. COL 40. **The severity of sanctions depends of the facts of each case and the value of the sanctions in preventing a recurrence of the violative conduct.**

In the Matter of Steven Muth, Exchange Act Release. No. 8622, 2005 WL 2428336 at *17-19 (Oct. 3, 2005).

Prop. COL 41. **Supervision must include regulatory compliance.**

In the Matter of John H. Gutfreund, 51 S.E.C. 93, 113 (Dec. 3, 1992) (determining if a particular person is a supervisor “depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability, or authority to affect the conduct of the employee whose behavior is at issue”); Poppalardo Test. at 1999:8-24 (“A: . . . I feel really strongly that - - that you just can’t parse the business activities from the regulatory requirements. . . . A: I’ve never seen it.”); *see also* Hasty Test. at 1746:9-13 (“Q: Did you ever believe that Mr. Pendergraft supervised Mr. Johnson from an operational perspective, and not from a regulatory perspective? A: No. I don’t believe you can separate the two.”); McCain Test. at 2203:10-17 (Q: . . . do you think an employee can have more than one supervisor? A: . . . I think it’s impractical. No, I don’t - - it doesn’t work.”).

Prop. COL 42. **In determining what sanctions to impose, Courts also consider: the age of the violation; the degree of harm to investors and the marketplace resulting from the violation; the deterrent effect of the sanction; the public-at-large; the welfare of investors; and standards of conduct in the securities industry business generally.**

See In re Prime Capital Services, Inc., et al., SEC Admin. Proc. File No. 3-13532, Initial Decision Release No. 398, 2010 WL 2546835, at *48 (June 25, 2010).

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Respectfully Submitted,



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